Dechert LLP

SEC Proposes Sweeping Changes to Liquidity Risk Management Practices Used by Mutual Funds and ETFs

A legal update from Dechert's Financial Services Group

October 2015

The Securities and Exchange Commission (SEC or Commission) on September 22, 2015 proposed a rule that would require all registered open-end funds and open-end exchange-traded funds (ETFs), other than money market funds (MMFs), to adopt liquidity risk management programs.[1] The Commission's proposal would also permit – but not require – registered open-end funds, other than ETFs and MMFs, to utilize "swing pricing" under certain circumstances. In addition, the proposal would impose new disclosure and reporting requirements related to a fund's liquidity risk management program and swing pricing policies.

The proposals are generally intended to: (i) reduce the risk that funds would be unable to meet shareholder redemption requests; and (ii) minimize the dilutive impact of fund shareholder purchase and redemption transactions. The proposals are in response to the growth of the U.S. asset management industry in general, including the growth of less liquid and alternative strategies, as well as the observations of the SEC Staff, which had conducted a review of current liquidity management practices used by funds.[2] According to SEC Chair Mary Jo White, "[p]romoting stronger liquidity risk management is essential to protecting the interests of the millions of Americans who invest in mutual funds and exchange-traded funds."[3]

The proposals represent potentially significant changes to current liquidity management practices used by funds, and, if adopted, will require significant changes to fund operations, disclosure and reporting. The proposals are the second part of a five-part plan "to enhance the regulation of the risks arising from the portfolio composition and operations of funds and investment advisers."[4] The Commission recently proposed the first part of this five-part plan – a proposal to modernize fund reporting and disclosure.[5] The remaining parts will include measures to "better address risks related to funds' use of derivatives, plan for the transition of client assets, and to stress test funds and advisers."

Comments on the proposals are due on or before 90 days after publication in the Federal Register. As of the date of this *OnPoint*, the proposals have not yet been published in the Federal Register. A summary of the proposals is provided below.[6]

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1 *See* *Open-End Fund Liquidity Risk Management Programs; Swing Pricing; Re-Opening of Comment Period for Investment Company Reporting Modernization Release* (Proposing Release). On the same day, the SEC made public a white paper prepared by the SEC's Division of Economic and Risk Analysis entitled "Liquidity and Flows of U.S. Mutual Funds." *See* Paul Hanouna, Jon Novak, Tim Riley and Christof Stahel, *Liquidity and Flows of U.S. Mutual Funds*, SEC Division of Economic and Risk Analysis (Sept. 2015).

2 *See id.* at 7 ("Commission staff engaged with large and small fund complexes to better understand funds' management of liquidity risk. Through these outreach efforts our staff has learned that, while some funds and their managers have developed comprehensive liquidity risk management programs, others have dedicated significantly fewer resources to managing liquidity risk in a formalized way. We believe proposing to address these variations in practices is appropriate and that it is in the interest of funds and fund investors to create a regulatory framework that would reduce the risk that a fund will be unable to meet its redemption obligations and minimize dilution of shareholder interests by promoting stronger and more effective liquidity risk management across open-end funds.").

3 Press Release, SEC Proposes Liquidity Management Rules For Mutual Funds And ETFs, Securities and Exchange Commission (Sept. 22, 2015).

4 Mary Jo White, Chair, Statement on Open-End Fund Liquidity Risk Management Programs and Swing Pricing, Securities and Exchange Commission (Sept. 22, 2015).

5 For additional information on the SEC's proposal to modernize fund reporting and disclosure, see US SEC Approves Proposal to Modernize Investment Company Reporting Regime, *Dechert OnPoint* (June 11, 2015).

6 In September 2015, the Financial Industry Regulatory Authority ("FINRA") published parallel guidance regarding effective liquidity risk management practices. This guidance follows FINRA's recent review of the liquidity risk management practices of 43 member firms. According to FINRA, the purpose of the guidance was to inform senior management and risk managers of the importance in establishing and implementing an effective liquidity risk management system. FINRA noted that it expects that each member firm would, among other things: (i) evaluate its liquidity needs in response to market wide stress and

Liquidity Risk Management Proposal: Program Overview and Scope

Proposed Rule 22e-4 under the Investment Company Act of 1940 (1940 Act) would require each fund[7] to adopt and implement a written liquidity risk management program. Each fund's program would be required to provide for the:

(i) classification and ongoing review of the liquidity of the fund's portfolio positions;

(ii) assessment and periodic review of the fund's liquidity risk; and

(iii) management of the fund's liquidity risk, including the requirement to determine the "three-day liquid asset minimum."[8]

Classifying the Liquidity of a Fund's Portfolio Positions

Liquidity Classification

The Commission's proposal would require each fund to classify each of the fund's portfolio positions (or portions of a position) into one of six liquidity categories. Under the proposal, the fund would also be required to engage in an ongoing review of each such classification. The liquidity categories would describe the number of days in which the fund's position (or portion thereof) would be convertible to cash at a price that does not materially affect the value of the asset immediately prior to sale. The determination to place an asset in a particular liquidity category would be made "using information obtained after reasonable inquiry" and would have to take into account, to the extent applicable, nine specified factors, which are described below.[9]

The proposed requirements relating to liquidity risk assessment and management (including a requirement to invest a minimum percentage of assets in three-day liquid assets (TDLAs)), as well as the proposed requirements relating to disclosure on proposed Form N-PORT, would be based in part on the liquidity classification requirement. As such, the liquidity classification requirement is a central feature of the Commission's proposal.

Liquidity Categories. A fund would be required to categorize each of the fund's positions in a portfolio asset (or portions of a position in a particular asset) into one of six liquidity categories. Specifically, positions would be categorized as "convertible to cash" within 1 business day, 2-3 business days, 4-7 calendar days, 8-15 calendar days, 16-30 calendar days or more than 30 calendar days. The phrase "convertible to cash" is defined in the proposal as "the ability to be sold, with the sale settled."[10] Because a position falling within the 2-3 business day liquidity category could also be considered to fall within the 4-7 calendar day liquidity category (such as when a position is

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idiosyncratic stresses; and (ii) allocate meaningful resources towards its liquidity risk management program. *See* FINRA Regulatory Notice 15-33, Liquidity Risk Guidance on Liquidity Risk Management Practices," (September 2015).

[7] The term "fund" is defined in the proposed rule as "an open-end management investment company that is registered or required to register under section 8 of the [1940 Act] … and includes a separate series of such an investment company," but does not include MMFs. The Proposing Release explains that each series of a fund is itself a fund, and must therefore develop a liquidity risk management program tailored to its own liquidity risk in order to comply with the proposed rule. As the Commission explains in the Proposing Release, "[t]o the extent that liquidity risk differs among each series of an investment company, each series would be required to adopt a liquidity risk management program whose liquidity risk assessment and management elements are distinct from other series' programs." Proposing Release, at 107 n.262.

[8] Under the Commission's proposal, each registered open-end fund, including ETFs (as well as exchange-traded managed funds or ETMFs), would be required to develop a liquidity risk management program in accordance with the proposed rules that is tailored to manage its liquidity risk. Closed-end funds and unit investment trusts (UITs) (including exchange-traded funds structured as UITs) would not be required to adopt liquidity risk management programs under the Commission's proposal.

[9] *See id.* at 63-64, 80.

[10] *See id.* at n.169.

sold on Thursday and the sale is settled on Monday), funds are instructed to classify the position using the shorter period (*i.e.*, the 2-3 business day liquidity category) in such cases.[11]

Classification of Positions. Under the Commission's proposal, funds will be required to classify each position in a portfolio asset (or portion thereof) using information obtained after reasonable inquiry.

A fund could determine to categorize portions of a position in a portfolio asset independently from other portions of the same position.[12] However, the Proposing Release notes that categorizing the liquidity of a portfolio position or portions thereof is ***not*** to be based solely upon the perceived liquidity of a normal trading lot for the relevant asset. According to the Proposing Release, "assessing liquidity only on the basis of [selling] a single trading lot … ignores the fact that a fund needing to sell certain assets in order to meet redemptions would almost certainly need to sell greater than one trading lot …."[13] Moreover, the Commission notes that assets should be classified based on "typical"[14] settlement periods for transactions in the relevant jurisdictions and mentions certain types of securities for which transaction settlement periods are normally relatively lengthy.[15]

The Proposing Release acknowledges the likelihood of different funds classifying the liquidity of identical portfolio positions differently, and affirms that the proposed rule does not assign certain asset classes to particular liquidity categories. Although the Proposing Release does not explain or expand upon the "reasonable inquiry" requirement, the Commission notes that an SEC staff examination of a fund's liquidity classifications (which may be triggered by "outlier classifications" reported on Form N-PORT, for example) would permit examination of "whether the fund considered the required factors" when determining liquidity classifications.[16] Thus, it appears that the Commission anticipates potential SEC staff review of a fund's liquidity classification process. Notably, however, the proposal would not require the retention of records relating to funds' liquidity classifications.[17]

Under the proposal, a position (or portion thereof) would be convertible to cash "at a price that does not materially affect the value of that asset immediately prior to sale" if the price the fund would receive is not reasonably expected to move the price of the asset in the market, independent of other market forces. The Proposing Release notes that this requirement is not meant to imply that funds are required to determine the current market price or fair value of an asset "immediately prior to sale."[18]

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11 *See id.* at 74. A position (or portion thereof) in an asset falling within the four remaining liquidity categories (4-7 calendar days, 8-15 calendar days, 16-30 calendar days and more than 30 calendar days) is defined in the proposed rule as a "less liquid asset." Thus, every fund position (or portions thereof) would be categorized as either a TDLA or as a less liquid asset.

12 For example, if 50% of a position could be converted to cash within one day, but it would take up to three days to convert the remaining 50% of that position to cash, those two portions of the position must be categorized separately.

13 *Id.* at 64, 66-67.

14 According to the Proposing Release, classifications should "not be based on the prospect of gaining expedited settlement." *Id.* at 75.

15 *Id.* at 67-69, 75. The Proposing Release states that certain foreign securities, agency mortgage-backed securities (other than secondary market trades) and U.S. bank loan participations "typically require settlement periods of more than three business days." *Id.* at 75.

16 *See id.* at 69.

17 *See id.* at 181-183 and the related request for comment ("Should a fund be required to keep a written record of how the liquidity classifications of each of the fund's positions in a portfolio asset were determined, including assessment of the factors set forth in proposed rule 22e-4(b)(2)(ii)?").

18 *See id.* at 64.

Factors to Consider in Liquidity Classifications

The proposal would require that funds take the following factors (Liquidity Classification Factors) into account, to the extent applicable, when classifying the liquidity of an asset:

- Existence of an active market for the asset, including whether the asset is listed on an exchange, as well as the number, diversity and quality of market participants;
- Frequency of trades or quotes for the asset and average daily trading volume of the asset (regardless of whether the asset is a security traded on an exchange);
- Volatility of trading prices for the asset;
- Bid-ask spreads for the asset;
- Whether the asset has a relatively standardized and simple structure;[19]
- For fixed income securities, maturity and date of issue;
- Restrictions on trading of the asset and limitations on transfer of the asset;[20]
- The size of the fund's position in the asset relative to the asset's average daily trading volume and, as applicable, the number of units of the asset outstanding;[21] and
- Relationship of the asset to another portfolio asset.[22]

If a fund lacks relevant information about a particular portfolio asset, the fund must consider the Liquidity Classification Factors as applied to similar assets. The Proposing Release notes that a fund may use third-party service provider data to inform its consideration of the Liquidity Classification Factors. However, the SEC cautions that, before relying on third-party service providers, funds "should consider having the person(s) at the fund or investment adviser tasked with administering the fund's liquidity risk management program review the quality of the

[19] The Proposing Release notes that the "issue of standardization is particularly significant with respect to the corporate bond market, since corporate issuers commonly have large numbers of bonds outstanding, and trading can be fragmented among that universe of bonds." *Id.* at 89.

[20] The Proposing Release acknowledges prior guidance with respect to factors relevant to the evaluation of liquidity of a Rule 144A security, and states that certain of the proposed Liquidity Classification Factors are consistent with such guidance. The Proposing Release also acknowledges that certain assets may be subject to contractual limitations on transfer and that these securities are generally less liquid than securities without such limitation. *Id.* at 92 (*citing* Stephen H. Bier, Julien Bourgeois & Joseph McClain, *Mutual Funds and Loan Investments,* The Investment Lawyer (Mar. 2015), at 2).

[21] When considering this factor, the proposal would require funds also to consider the extent to which the timing of disposition of the position could create any market value impact. *See id.* at 95.

[22] According to the Proposing Release, with respect to assets segregated and used to "cover" a fund's obligation under certain types of transactions (as provided in Investment Company Act Release No. 10666 (Apr. 18, 1979) (Release 10666)), such as derivatives transactions, the segregated assets are "frozen" and "unavailable for sale or other disposition" until the related derivatives position is disposed of or unwound. The Proposing Release states that "a fund should classify the liquidity of these segregated assets using the liquidity of the derivative instruments they are covering." Proposing Release at 96 (emphasis added). Classifying segregated assets as having the same liquidity as the derivatives they are covering may represent a significant change in current segregation practices for many funds.

Similarly, with respect to other circumstances (such as certain hedging transactions) where relatively more liquid assets are held by a fund in connection with holding a relatively less liquid asset and the fund plans to transact in the more liquid asset only in connection with the less liquid asset, the fund should consider the less liquid asset's liquidity when determining the more liquid asset's liquidity classification. *Id.* at 97.

data received from third parties, as well as the particular methodologies used and metrics analyzed by third parties, to determine whether this data would effectively inform or supplement the fund's consideration of the proposed liquidity classification factors."[23]

Ongoing Review of Liquidity Classifications

The proposal would require a fund to review the liquidity classification of each of the fund's portfolio positions on an ongoing basis using the Liquidity Classification Factors, and to revise such liquidity classifications as appropriate. No specific review procedures are proposed and funds would not be required to monitor for specific developments. However, the Proposing Release notes that a fund should have policies and procedures intended to identify market developments and security- and asset-class-specific developments that could impact the liquidity classification of a portfolio position.[24]

The Proposing Release also notes that the frequency of a fund's ongoing review may be determined based, in part, on the liquidity of its portfolio holdings and the timing of portfolio acquisitions and turnover. In this regard, the Proposing Release notes that daily, or even hourly, review of liquidity classifications may be appropriate in some circumstances (such as where portfolio liquidity may depend significantly on current market conditions), while in other circumstances, where portfolio liquidity is generally more stable, less frequent review of liquidity classifications may be appropriate. At a minimum, monthly review of liquidity classifications would be required in order to ensure the accuracy of information reported on proposed Form N-PORT.

Assessing and Periodically Reviewing a Fund's Liquidity Risk

The proposal would require each fund to assess and periodically review its "liquidity risk," taking into account certain specified factors. "Liquidity risk" would be defined as "the risk that the fund could not meet requests to redeem shares issued by the fund that are expected under normal conditions, or are reasonably foreseeable under stressed conditions, without materially affecting the fund's net asset value." The Proposing Release explains that, in light of this proposed definition, funds would have to consider both expected redemption requests (such as seasonally-related fund flows or flows related to tax matters) as well as redemption requests that are unexpected but reasonably foreseeable under stressed conditions (such as fund flows related to market conditions, volatility, reputational events or portfolio management changes).[25]

The Commission's proposal would require each fund to consider the following factors (Liquidity Risk Assessment Factors), as applicable, in assessing the fund's liquidity risk.[26]

- Short-term and long-term cash flow projections, taking into account the following considerations:
  - Size, frequency, and volatility of historical purchases and redemptions of fund shares during normal and stressed periods;[27]

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[23] According to the Proposing Release, "[t]his review could include an assessment of whether modifications to an 'off-the-shelf' product are necessary to accurately reflect the liquidity characteristics of the fund's portfolio holdings." *Id.* at 82.

[24] *Id.* at 101-102.

[25] *Id.* at 103.

[26] The Proposing Release notes that this list is not intended to be exhaustive, and that liquidity risk assessments may include additional factors, such as the results of stress testing. *Id.* at 108.

- The fund's redemption policies;[28]
- The fund's shareholder ownership concentration;
- The fund's distribution channels;[29] and
- The degree of certainty associated with the fund's short-term and long-term cash flow projections;[30]

- Investment strategy and liquidity of portfolio assets;[31]
- Use of borrowings and derivatives for investment purposes;[32] and
- Holdings of cash and cash equivalents, as well as borrowing arrangements and other funding sources.[33]

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27 The Proposing Release suggests that funds may wish to understand when the highest, lowest, most frequent and most volatile purchases and redemptions occurred over the past one, five, ten and twenty years, as applicable. Additionally, the Proposing Release notes that funds (particularly those without substantial operating histories) may wish to consider purchase and redemption activity in other funds sharing similar investment strategies. Moreover, the Proposing Release suggests evaluating whether the size, frequency, and volatility of historical purchases and redemptions follow patterns (such as in connection with seasons, tax considerations, fund advertising and changes in fund performance ratings). Finally, the Proposing Release notes that a fund's investment strategy may be a factor contributing to fund flows. *Id.* at 111-112.

28 The Proposing Release explains that funds should consider obligations for paying redemption proceeds based on fund disclosures and how distribution channels may affect redemption policies. For example, due to the requirements of Rule 15c6-1 under the Securities Exchange Act of 1934 (Exchange Act), open-end funds that are redeemed through broker-dealers must meet redemption requests within three business days. *See id.* at 113 and 13 n.21 (*citing* Letter from Jack W. Murphy, Associate Director and Chief Counsel, Division of Investment Management, SEC, to Paul Schott Stevens, General Counsel, Investment Company Institute (May 26, 1995)). Additionally, ETFs that typically pay redemption proceeds in-kind should consider the impact on cash flow projections of policies and expectations with respect to transacting in cash with authorized participants. *Id.* at 114.

29 The Proposing Release notes that fund distribution channels may affect cash flows in several ways: redemption practices may depend upon distribution channels (as discussed above, open-end funds that are redeemed through broker-dealers must meet redemption requests within three business days as a result of Exchange Act Rule 15c6-1); the omnibus account structure may limit awareness of the underlying investor base (making an assessment of ownership concentration difficult); and certain distribution channels may be correlated with particular purchase and redemption patterns (for example, in the case of distribution through retirement plan or other planned savings channels, purchase and redemption patterns may be more predictable). *Id.* at 115.

30 The length of a fund's operating history and experience with market events, observed patterns in purchases and redemptions, and any policies encouraging shareholders to provide advance notice of large redemptions are all examples of factors that the Proposing Release notes may be relevant in a fund's consideration of the certainty of its cash flow projections. The Proposing Release also mentions the use of ranges in considering cash flow projections as a potentially instructive practice. *Id.* at 116.

31 Among other considerations, the Proposing Release discusses how a fund's liquidity risk could be affected by the fund's: (i) diversification status under the 1940 Act; (ii) status as a regulated investment company under the Internal Revenue Code; and (iii) principal investment strategies. The Proposing Release also states that, when assessing liquidity risk, funds should consider the relative proportion of net assets invested in each of the proposed liquidity categories. *Id.* at 118-120.

32 In addition to the liquidity considerations associated with "covering" borrowings or derivative transactions with liquid assets in accordance with Release 10666 (as discussed above), the Proposing Release notes that an assessment of a fund's liquidity risk should include consideration of settlement periods and pricing difficulties associated with complex derivative transactions, as well as any potential obligations with respect to variation margin or collateral calls. *Id.* at 121-122.

33 Although the proposed rule text does not define "cash equivalents," the Proposing Release cites the U.S. generally accepted accounting principles (US GAAP) definition in explaining that "cash equivalents" are short-term, highly liquid investments that are readily convertible to known amounts of cash and that are so near their maturity that they present insignificant risk of changes in value because of changes in interest rates. Examples of cash equivalents listed in the Proposing Release include: certain Treasury bills; agency securities; bank deposits; commercial paper; and shares of MMFs. *Id.* at 122-123.

In assessing the effect of borrowings (particularly lines of credit with commercial banks) on liquidity risk, the Proposing Release notes that funds should consider the terms and amount of the credit facility, whether the line of credit is a committed or standby line of credit, and the financial health of the bank(s) providing the credit facility. Moreover, the Proposing Release states that if multiple funds in a fund family share a credit facility, the liquidity risk of such funds are related. The Proposing Release states that the terms of interfund lending arrangements, as well as any conditions required under Commission exemptive relief

Under the proposal, funds would also be required to periodically review a fund's liquidity risk in light of the Liquidity Risk Assessment Factors. The Commission did not propose specific review procedures, timing or events that must be considered in a fund's periodic review of liquidity risk. However, the Proposing Release notes that a fund may wish to include procedures for evaluating regulatory, market and fund-specific developments in its periodic review procedures.[34]

Managing a Fund's Liquidity Risk

Three-Day Liquid Assets

A central feature of the Commission's liquidity risk management proposal is a set of requirements pertaining to minimum investments in TDLAs. As discussed above, the proposal defines TDLAs as any cash held by a fund and any fund position (or portion thereof) in an asset that the fund believes is convertible to cash within three business days at a price that does not materially affect the value of that asset immediately prior to sale. Under the proposal, the Liquidity Classification Factors must be considered in determining whether an asset is a TDLA.

Three-Day Liquid Asset Minimum. The proposal would require each fund to determine a three-day liquid asset minimum (TDLA Minimum), which is the percentage of the fund's net assets that must be invested in TDLAs. To determine its TDLA Minimum, a fund must consider the Liquidity Risk Assessment Factors discussed above. The proposal requires that a written record of this determination must be maintained, the fund's board must approve both the TDLA Minimum and any changes to the TDLA Minimum, and the TDLA Minimum must be publicly disclosed on proposed Form N-PORT (if adopted).[35]

According to the Proposing Release, the proposed TDLA Minimum is intended to be forward-looking and based largely on projected future redemptions. The Commission expects that each fund's TDLA Minimum will be greater than zero and that the TDLA Minimum may vary between funds (even funds that share the same strategy). Under the proposal, in addition to cash and cash equivalents, funds may determine to include a variety of assets in the holdings satisfying the TDLA Minimum, including equity, debt, derivatives and asset-backed securities.[36]

As the "primary goal of a minimum level of liquidity is to ensure that each fund is able to meet redemptions and to do so with minimal dilution of shareholders' interests," the Commission considers cash flow projections as "pivotal to setting an appropriate" TDLA Minimum.[37] In discussing this and other Liquidity Risk Assessment Factors in the context of determining the TDLA Minimum, the Proposing Release made several notable points. For example, the Proposing Release suggests that funds employ stress testing in determining their TDLA Minimum. Additionally, the Proposing Release notes that, where a fund's visibility into its shareholder base is limited (as a result of the use of particular distribution channels) or where a fund faces uncertainty with respect to market conditions, the Commission

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associated with such arrangements, are relevant to assessing the effect of interfund lending programs on fund liquidity risk. Finally, the Proposing Release notes that funds should consider statutory and regulatory restrictions on affiliated transactions and leverage when assessing liquidity risk. *Id.* at 123-127.

[34] *Id.* at 129.

[35] The Proposing Release notes that this written record would enable Commission staff to determine whether a fund is considering the Liquidity Risk Assessment Factors in connection with determining its TDLA Minimum. *Id.* at 138. The requirement to maintain a written record of the TDLA Minimum determination contrasts with the proposed approach in the context of liquidity classification determinations, although in both cases, SEC staff review is contemplated. *See supra* n.17 and accompanying text.

[36] Proposing Release at 138, 140-141.

[37] *Id.* at 134.

expects the fund's TDLA Minimum to reflect the related uncertainty in the fund's net redemption projections (such as by incorporating a multiple of cash flow projections into the TDLA Minimum). With respect to borrowings and derivatives, the Proposing Release suggests that a fund should consider any "significant fixed obligations to derivatives counterparties (for example, from a total return swap or writing credit default swaps)." However, no guidance was provided concerning the appropriate measure of such obligations (*i.e.*, notional value or mark-to-market value).

Periodic Review of TDLA Minimum. The Commission views the determination of the TDLA Minimum as a "cornerstone of a fund's liquidity risk management," and accordingly proposes to require funds to review the TDLA Minimum's adequacy no less frequently than semi-annually. More frequent reviews of the TDLA Minimum are permitted and may be appropriate, as the Commission considers the determination of the TDLA Minimum to be a "dynamic process" that incorporates new information about the market and the fund as needed. Specific procedures for reviewing the TDLA Minimum's adequacy are not proposed, but the Proposing Release suggests including procedures for evaluating regulatory, market and fund-specific developments, as well as procedures specifying circumstances that trigger ad-hoc review of the TDLA Minimum and procedures governing such ad-hoc reviews.

Limits on Acquiring Non-TDLAs. Under the proposal, a fund would be prohibited from acquiring any less liquid asset[38] if, immediately after the acquisition, the fund would have invested less than its TDLA Minimum in TDLAs. However, a fund would not be required to divest less liquid assets and reinvest in TDLAs in the event that the TDLA Minimum is not satisfied (for example, if the value of a TDLA decreased, causing the fund to have invested less than its TDLA Minimum in TDLAs).

15% Standard Assets

In addition to the floor imposed by the proposed TDLA Minimum, the Commission proposes a 15% limit on the amount of relatively illiquid assets a fund may acquire. Specifically, under the proposal, a fund would be prohibited from acquiring any "15% standard asset" if, immediately after the acquisition, the fund would have invested more than 15% of its net assets in 15% standard assets.[39] This proposal essentially codifies the Commission's current guideline on investments in illiquid assets.

Under the proposal, a 15% standard asset would be any asset that may not be sold or disposed of in the ordinary course of business within seven calendar days at approximately the value ascribed to it by the fund. The Proposing Release notes that assets included among 15% standard assets would be consistent with the types of assets currently considered "illiquid" under the Commission's existing guideline.[40] Because the SEC views the proposal as providing a more comprehensive framework for evaluating the liquidity of fund assets, the Commission proposes to withdraw the prior guidance regarding the existing 15% guideline.[41]

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[38] As discussed above, a "less liquid asset" is any fund position (or portion thereof) of an asset that is not a TDLA.

[39] The proposed rule text included in the Proposing Release refers to a fund being prohibited from acquiring any 15% standard asset if, immediately after the acquisition, the fund would have invested more than 15% of its total assets in 15% standard assets. *See id.* at 405. In all other cases, the Proposing Release refers to net assets in this context.

[40] *Id.* at 153; *see also id.* at nn.92-93 and accompanying text (discussing Commission guidelines regarding holdings of "illiquid assets").

[41] *Id.* at 153. The prior guidance proposed to be withdrawn includes guidance contained in the following releases: *Revisions of Guidelines to Form N-1A*, SEC Rel. No. IC-18612 (Mar. 12, 1992); *Resale of Restricted Securities; Changes to Method of Determining Holding Period of Restricted Securities Under Rules 144 and 145*, SEC Rel. No. IC-17452 (Apr. 23, 1990); and *Statement Regarding "Restricted Securities,"* SEC Rel. No. IC-5847 (Oct. 21, 1969).

The Proposing Release notes several key distinctions between the definition of 15% standard assets and the proposed liquidity classification requirements. First and foremost, unlike the proposed liquidity classification requirements, for purposes of the definition of 15% standard asset, a fund would ***not*** be required to consider the size of its position in the asset. If a fund can sell a standard lot size within seven calendar days at approximately the value ascribed to the asset by the fund, the entire position in the asset would be deemed not to be a 15% standard asset.[42] Additionally, a fund would not be required to consider the number of days associated with receipt of proceeds of sale or disposition of the asset. Moreover, under the proposal, a fund would not be required to consider any specific factors in determining whether an asset is a 15% standard asset. As a result of these distinctions, in some cases the same asset may be a less liquid asset under the liquidity classification requirements but not a 15% standard asset.

Board Responsibilities and Designation of Liquidity Risk Management Program Administrator

Under the proposal, a fund would have to obtain initial approval from its board of directors, including a majority of its independent directors, of the fund's liquidity risk management program, including the TDLA Minimum. Fund directors may satisfy their obligations regarding this initial approval by reviewing summaries of the fund's liquidity risk management program that provide information on the program's most important features and an understanding of how the program addresses the proposal's required liquidity risk assessment and of the determination of the TDLA Minimum. Directors should consider the nature of the fund's liquidity risk exposure and the adequacy of the fund's liquidity risk management program in light of experiences related to fund liquidity. The proposal would also require a fund to obtain approval from its board of directors, including a majority of its independent directors, of any material changes to the liquidity risk management program, including changes to the TDLA Minimum.

The proposal would also require that a fund's board, including a majority of the independent directors, review no less frequently than annually a written report from the Program Administrator (defined below) that reviews the adequacy and effectiveness of implementation of the fund's liquidity risk management program, including the TDLA Minimum. The Proposing Release notes that, where a fund's board is asked to approve a change to the fund's TDLA Minimum, the written report should provide the board with an understanding of how such change was determined to be appropriate.

The proposal would also require that a fund's board, including a majority of the independent directors, approve the entity or person(s) designated by the fund as responsible for administering the fund's liquidity risk management program (Program Administrator). Under the proposal, the fund would be required to designate its investment adviser or officers (who may not be solely portfolio managers of the fund) as the Program Administrator.[43] In addition to the written report discussed above, the Proposing Release notes that the Program Administrator should generally provide the board with sufficient information to allow the Board to oversee the Program Administrator's administration of the liquidity risk management program. Additionally, in the event of serious compliance issues under the liquidity risk management program, the Program Administrator should consider whether those issues should promptly be brought to the board's attention.[44]

[42] Proposing Release at 154-155; *see supra* n.13 and accompanying text.

[43] A fund may also designate a sub-adviser as the Program Administrator. *Id.* at n.405.

[44] *Id.* at 177-178.

Related Commission Guidance and Proposal: Additional Liquidity Risk Management Tools; Cross-Trades; Redemptions in Kind

In the Proposing Release, the Commission provides guidance with respect to certain additional liquidity risk management tools and cross-trades. The Commission notes that its discussion of borrowing and other funding arrangements could be used by funds in assessing whether to enter into such arrangements and in reviewing existing arrangements of this nature. To the extent a fund uses ETFs as a liquidity risk management tool (such as investing in an ETF with a similar investment strategy to that of the fund to enhance the fund's portfolio's liquidity), the Commission encourages the fund to assess the liquidity characteristics of the ETF's underlying securities, as well as the characteristics of the ETF itself, in classifying the ETF's liquidity under the proposal and in considering the inclusion of ETF shares in TDLAs.

The Proposing Release also notes that funds may seek to use cross-trading as a liquidity risk management tool. However, the Commission notes that certain requirements under Rule 17a-7,[45] including the requirement that market quotations for the security transacted be readily available and the requirement that the transaction be effected at the independent "current market price," may be less likely to be satisfied where the security in question is less liquid. Accordingly, the Commission stated that less liquid assets may be ineligible to trade under Rule 17a-7.[46]

Finally, to the extent a fund engages in or reserves the right to engage in redemptions in kind, the Commission proposes to require that funds establish policies and procedures that address the process for such redemptions and the circumstances under which the fund would consider redeeming in kind.[47]

Swing Pricing

Overview and Scope

Under the proposal, funds (excluding MMFs and ETFs) would be permitted, but not required, to use "swing pricing" to mitigate the risk that shareholder purchase and redemption activities could dilute the value of fund shares. For example, when a shareholder tenders fund shares for redemption, a fund may be required to dispose of securities to generate sufficient cash to satisfy the redemption request. The dilution occurs because the costs associated with this trading activity are typically *not* reflected in the price received by the redeeming shareholder.[48] Swing pricing generally refers to a mechanism that would adjust the NAV of a fund's shares to effectively pass on the trading and other costs associated with purchases or redemptions of fund shares to the purchasing or redeeming shareholder. Before a fund could employ swing pricing, it would be required to establish policies and procedures that designate an amount (the swing factor) by which the fund will adjust its NAV if the level of net purchases into or net redemptions from the fund has exceeded a specified percentage of the fund's NAV (the swing threshold). In addition, the policies and procedures would be required to: (i) provide for the periodic review (at least annually) of the fund's swing

[45] 1940 Act Rule 17a-7 provides an exemption from the 1940 Act Section 17(a) prohibitions on certain transactions between a fund and its first- or second-tier affiliates. The exemption is conditioned upon satisfaction of certain enumerated criteria.

[46] Proposing Release at 171-173. Rule 17a-7, by its terms, does not contain any provisions concerning liquidity.

[47] *Id.* at 162.

[48] Under Rule 22c-1, a fund must price its shares based on the current net asset value (NAV) next calculated after the fund receives the purchase or redemption order. However, as permitted by Rule 2a-4, a fund's NAV is not required to reflect changes in the fund's portfolio holdings and changes in the fund's outstanding shares until the first business day after the fund receives the purchase or redemption order. Swing pricing would allow a fund to direct these costs to the purchasing or redeeming shareholders that triggered the fund's trading activity.

threshold; (ii) specify how the fund calculates the swing factor in the event the fund's swing threshold is breached; and (iii) be approved by the fund's board, including a majority of the independent directors.

According to the Proposing Release, in recent years, there has been a trend towards the adoption of swing pricing in Europe by major market participants. Furthermore, the proposal indicates that industry trade associations in France and Luxembourg have already adopted guidelines on swing pricing procedures. According to the Commission, the swing pricing policies contemplated by the proposal are similar to those used abroad.

Swing Threshold

A fund's swing threshold would be the amount of net purchases into or net redemptions from a fund that triggers the implementation of swing pricing. In-kind purchases and redemptions would be excluded from this calculation. According to the Proposing Release, a fund's swing threshold "should generally reflect the estimated point at which net purchases or net redemptions would trigger the fund's investment adviser to trade portfolio assets in the near term, to a degree or of a type that may generate material liquidity or transaction costs for the fund."[49] To assist a fund in predicting the levels of purchases and redemptions that would cause a fund to incur material costs, the proposal would require the fund to consider, at a minimum, the following factors:

- The size, frequency and volatility of historical net purchases or net redemptions of fund shares during normal and stressed periods;
- The fund's investment strategy and the liquidity of the fund's portfolio assets;
- The fund's holdings of cash and cash equivalents, as well as borrowing arrangements and other funding sources;[50] and
- The costs associated with transactions in the markets in which the fund invests.[51]

The Commission recognizes the possibility that a fund could set a swing threshold at a very low level, as there is no minimum "floor" requirement in the proposal. In theory, this could effectively result in a fund requiring an adjustment to its NAV *any time* there are net purchases or net redemptions. However, the Commission does not anticipate that funds would want to engage in this practice as frequent swing pricing would likely increase the volatility of the fund's NAV in the short term. An increase in NAV volatility could cause a fund's performance to deviate from its benchmark (*i.e.*, tracking error) and potentially lead to investor confusion regarding the short-term relative performance of the fund.

The Commission also recognizes that there is a potential for fund shareholders to effectively "game" the fund's use of swing pricing by attempting to time their purchases and redemptions based on the likelihood that a fund would or would not adjust its NAV. However, the Commission does not believe this is a significant concern since fund complexes would not be required to disclose their swing thresholds or daily net cash flows. Accordingly, the

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[49] Proposing Release, at 213. In general, a fund may incur material costs in connection with trading illiquid assets in a short period of time to meet significant purchase or redemption requests. However, trading smaller levels of very liquid assets likely would not produce significant costs to the fund.

[50] These first three factors correspond to the Liquidity Risk Assessment Factors. The Commission believes that assessing a fund's liquidity risk is a "similar exercise to determining the fund's swing threshold." *Id.* at 214-215.

[51] A fund should consider market impact costs and spread costs, as applicable, that the fund typically incurs when it purchases or sells a security. A fund may also wish to consider transaction fees and other charges (*e.g.,* brokerage commissions and custody fees) that the fund typically is required to pay in connection with these transactions. *Id.* at 215.

Commission indicated that it is not likely that shareholders would be able to discern when net purchases or net redemptions exceed a fund's swing threshold.[52]

The determination of a fund's swing threshold would be required to be made pursuant to policies and procedures approved by the fund's board. In addition, a fund would be required to assess its swing threshold no less frequently than annually, taking into consideration the factors set forth above. Any change to a fund's swing threshold, including as a result of this review, would require approval by the fund's board.

Swing Factor

Under the Commission's proposal, a fund's swing factor would be defined as the amount by which the fund adjusts its NAV when the fund's net purchases or net redemptions cross the fund's swing threshold. According to the Commission, this amount should reflect the estimated costs associated with purchase and redemption activity that could dilute the value of existing shareholders' interests in the fund.

A fund's swing factor would be required to take into account any near-term costs expected to be incurred as a result of net purchases or net redemptions that occur on the day the swing factor is employed. These costs would include market-related costs and transaction-related fees, including taxes, as well as any borrowing-related costs incurred by the fund in order to meet a redemption request. The proposal contemplates that a fund likely will have to estimate certain of these costs, and therefore the swing factor would represent an estimate of the combined costs associated with purchase or redemption activity. Moreover, the swing factor would account for near-term costs expected to be incurred by the fund, which is meant to reflect that certain costs may not be incurred for several days. For example, a fund may use cash reserves to satisfy redemptions, which likely would result in minimal immediate costs. Yet, the fund could incur significant costs when it rebalances its portfolio in the next several days to replenish cash reserves. Under the proposal, these costs could be accounted for in the swing factor as they directly relate to, and are not significantly removed in time from, the purchases or redemptions at issue.

A fund's swing factor would also be required to take into account the value of assets purchased or sold by the fund to satisfy shareholder redemption or purchase requests on the day the swing factor is employed, but only if such information would not be reflected in the fund's current NAV computed on that day. This requirement would be intended to capture those costs stemming from shareholder purchases or redemptions that are not calculated into a fund's NAV until the first business day following the receipt of the shareholder's purchase or redemption request, as permitted under current pricing rules.

Approaches to Determining the Swing Factor. A fund's swing pricing policies and procedures would be required to specify how a fund will determine the swing factor to be used to adjust the fund's NAV.

The calculation of a fund's swing factor would incorporate an assessment of multiple sources of potential dilution, and so the relevant factors used by a fund in determining its swing factor could vary depending on the facts and circumstances of the particular fund. In light of these considerations, the Commission's proposal provides flexibility for a fund to take a variety of approaches in determining its swing factor. For example, a fund may choose to set an initial "base" swing factor, which could then be adjusted under certain circumstances. Alternatively, a fund may choose to utilize a formula or algorithm that includes certain factors required to be considered in determining the swing factor. In

[52] The Commission also notes that the selective disclosure of a fund's swing threshold to certain shareholders could "facilitate fraud." *Id.* at 216-217 and n.483.

addition, a fund would be allowed to incorporate the use of reasonable estimates for costs that may be difficult to know with precision, to the extent that estimates are deemed necessary or appropriate.

In determining its swing factor, a fund would not be limited by a “ceiling” requirement. The Commission believes that a “ceiling” on the swing factor would be inappropriate given that the costs associated with shareholder purchase or redemption activities differ across funds and under different market conditions. Thus, a “ceiling” would likely be an ineffective tool for mitigating potential dilution. However, a fund would be permitted to voluntarily adopt an upper limit on its swing factor.[53] According to the Commission, such a limit may yield potential benefits to shareholders, including increased transparency regarding the maximum amount that a shareholder could expect the share price to be adjusted as a result of swing pricing. The Commission believes that a fund likely would not set its swing factor artificially high because the swing factor must be determined with reference to the factors discussed above and the policies and procedures for determining the swing factor must be approved by the fund’s board.

Application of the Swing Factor. If a fund’s swing threshold is breached, the swing factor would be applied equally to *all* purchasing and redeeming shareholders, regardless of the size of their orders or whether such orders would likely create material trading costs for the fund. This could result in certain benefits or costs to shareholders relative to other shareholders in the fund, which otherwise would not exist in the absence of swing pricing. For instance, a small investor is not likely to create significant liquidity costs for the fund on its own, but if such an investor were to redeem his or her shares on a day that the fund’s net redemptions breached the swing threshold (*e.g.*, due to large net redemptions from institutional shareholders), he or she would receive a lower price than would otherwise be the case as a result of the downward NAV adjustment. The Commission believes these concerns would be partially mitigated because shareholders would be assured that the same threshold of net purchase and net redemption activities would consistently trigger the use of swing pricing.

From an operational standpoint, a fund using swing pricing would need to monitor shareholder trades or flows of money into and out of the fund for purposes of determining whether the fund’s net purchases or net redemptions would cross the fund’s swing threshold, thereby triggering the swing factor. The persons administering the fund’s swing pricing policies and procedures may have limited time in which to make this determination. To the extent that purchases and redemptions cannot be reasonably ascertained or reasonably estimated until around the time a fund must strike its NAV, the proposal contemplates that such persons may estimate cash flows using “information obtained after reasonable inquiry.” In this regard, the Commission suggests that a fund may wish to arrange for interim feeds of fund flows from its transfer agent or distributor in order to reasonably estimate its daily net flows for swing pricing purposes.[54] Effective communication channels between the various entities charged with implementing swing pricing would therefore be an essential component of any fund’s swing pricing policies and procedures.

Board Considerations

Although a fund’s board, including a majority of the independent directors, would have to initially approve the fund’s swing pricing policies and procedures (and any material changes thereto), the board would not be required to manage the administration of such policies and procedures. Instead, the board would be required to designate the fund’s investment adviser or officers responsible for administering these policies and procedures, including responsibility for determining an appropriate swing factor should the swing threshold be breached. As a fund may

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[53] According to a study cited by the SEC, certain foreign funds that use swing pricing voluntarily set a limit on the level of the swing factor to be applied, which usually ranges from 1% to 3%. *See* Luxembourg Swing Pricing Survey, Reports and Guidelines, at 7.

[54] *See* Proposing Release, at 238-239.

choose to adopt swing pricing policies and procedures as part of its liquidity risk management program, the fund's board may wish to provide that the persons (or functional areas) responsible for administering the swing pricing policies and procedures overlap with the Program Administrator.[55] The Commission suggests that a board may wish to consider appointing a committee to administer the fund's swing pricing operations. In addition, the proposal indicates that the board should specify the officers or functional areas that comprise the committee and the regularity with which the committee would meet to determine the swing factor(s) the fund would use in a variety of circumstances. According to the Commission, the proposed board oversight requirements would "reflect the historical role that a fund's board and independent directors have held with respect to issues involving valuation."[56]

Alternative Pricing Mechanisms Considered by the SEC

The Proposing Release also discusses and seeks comment on a number of other pricing mechanisms that could serve to mitigate potential dilution, but which would not be permitted under the proposal.

Partial Swing Pricing vs. Full Swing Pricing. The proposal contemplates partial swing pricing, which involves a NAV adjustment only in the event that net purchases or net redemptions exceed a certain threshold specified by the fund. Full swing pricing, on the other hand, would eliminate the threshold requirement and instead require that a NAV adjustment be made *any time* the fund experiences net purchases or net redemptions. Although there may be advantages to full swing pricing – including greater transparency, consistent treatment of all shareholder transactions and the removal of the costs associated with determining an appropriate swing threshold – the Commission stated its belief that partial swing pricing, on balance, is preferable to full swing pricing because it would generally result in reduced volatility and tracking error concerns. In addition, the Commission believes that the threshold requirement recognizes that NAV adjustments might not be appropriate under certain circumstances, such as when purchases or redemptions would not lead to fund trading activity that results in material costs to the fund.[57]

Purchase and Redemption Fees or Liquidity Fees. While purchase and redemption fees or liquidity fees would be an easy concept for investors to understand and would likely not produce the same volatility and tracking error concerns as swing pricing, the Commission believes that, on balance, the operational costs and difficulty of imposing a fee would be significantly higher than those associated with swing pricing. In this regard, the Commission notes that implementing a fee would require coordination with the fund's service provider and the systems used by intermediaries, which could create operational difficulties, whereas adjusting a fund's NAV would occur pursuant to the fund's own procedures and would be factored into the process by which the fund strikes its NAV.

Dual Pricing. The Commission considered the use of "dual pricing," a practice that is currently utilized by certain foreign funds to mitigate potential dilution arising from shareholder transaction activity. A fund that uses dual pricing would quote separate prices for purchasing and redeeming shareholders. The price at which a shareholder purchases fund shares would be set higher to reflect the costs associated with buying portfolio assets at the ask price in the market, whereas the price at which a shareholder redeems fund shares would be set lower to reflect the proceeds the fund would receive from selling portfolio securities at the bid price in the market. Despite acknowledging that dual pricing could mitigate potential dilution, the Commission stated its belief that swing pricing would be easier to implement since it would enable a fund to continue to transact in fund shares using one price, as opposed to setting two different prices. Further, swing pricing would permit a fund to price its shares without a NAV adjustment if

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[55] *Id.* at 233.

[56] *Id.* at 230-231.

[57] *Id.* at 198-199.

the fund's swing threshold is not breached. The Commission also stated its belief that swing pricing would be simpler to understand than dual pricing, from an investor's perspective. [58]

Disclosure and Reporting Requirements

The Commission's proposal outlines updates to fund disclosure and reporting requirements:

Form N-1A

Currently, Form N-1A requires funds to include a description of their policies and procedures for redeeming fund shares. In this regard, registrants are required to disclose any restrictions or redemption charges, as well as other redemption information (such as the timing of payments to redeeming shareholders). According to the Commission, there are various inconsistencies in how funds describe their redemption policies and procedures. The Commission believes that investors would benefit from additional disclosure regarding a fund's redemption practices. In response to these inconsistencies, the SEC proposed amendments to Item 11 of Form N-1A, which would require funds to disclose the number of days in which they will pay redemption requests to redeeming shareholders. In addition, funds would be required to disclose the number of days each distribution channel will satisfy redemption requests should the number of days vary across distribution channels. Moreover, the Commission's proposal would require that funds describe the methods they will use to meet redemption requests (*i.e.,* sale of portfolio securities, cash reserves, lines of credit), including whether such methods will be used regularly or only when there is increased market volatility.

Under the proposal, funds would also be required to file, as an exhibit to their registration statements, any agreements entered into for the purpose of accessing lines of credit on behalf of the fund. The SEC staff indicated that it is common practice for funds to enter into such arrangements to mitigate the liquidity risks associated with large purchases or redemptions, especially during times of market volatility. However, funds would not be required to disclose the fees associated with such arrangements.[59] Funds that decide to use swing pricing would be also required to include an explanation in their registration statements regarding the circumstances in which the funds will use swing pricing as well as the effects of initiating swing pricing.

Form N-PORT

In May 2015, the Commission proposed a series of rules that would expand the reporting and disclosure requirements of registered investment companies, including a new requirement to file monthly portfolio investment information on Form N-PORT. Although Form N-PORT would be filed monthly, only the information reported for the third month of a fund's fiscal quarter would be made publicly available (subject to a 60-day delay). Building on this earlier proposal, the Commission is proposing three amendments to Form N-PORT:

- **Liquidity Classification of Portfolio Investments.** Funds would be required to identify the liquidity classification category (described above) of each portfolio asset based on the number of days the fund anticipates it would take to convert the asset to cash.
- **"15% Assets" to Replace "Illiquid Assets."** Funds would be required to report whether each portfolio asset is a 15% standard asset. According to the proposal, the Commission believes this enhanced disclosure will

[58] *Id.* at 196-197.

[59] *Id.* at 253.

enable the SEC staff to better understand the nature of a fund's holdings and track any exposure to liquidity risk.

- **"Three-Day Liquid Asset Minimum."** Funds would be required to disclose their "three-day liquid asset minimum."

Form N-CEN

In May 2015, the Commission also proposed Form N-CEN, which would require all registered investment companies (including UITs) to report certain census-type information on an annual basis. The Commission is now seeking to amend that previous proposal to require that funds provide additional information regarding the use of lines of credit, interfund lending and borrowing, and swing pricing. With respect to lines of credit, a fund would be required to disclose: (i) whether it has entered into a committed line of credit; (ii) the size of the line of credit (in U.S. dollars); (iii) the name of the institution that is providing the line of credit; and (iv) whether other funds in the fund complex can access the line of credit and the names of those funds. There would also be additional disclosure requirements for any fund that draws on its line of credit during the relevant reporting period.

If a fund engages in interfund lending and/or borrowing during any given reporting period, the fund would be required to disclose the average amount of the loan when the loan was outstanding as well as the period of time the loan was outstanding. Lastly, the proposal would require a fund to disclose whether it used swing pricing during the relevant reporting period.

Financial Statement Reporting

The impact of swing pricing would need to be reflected in a fund's financial statements, including the fund's balance sheet and the notes to the financial statements. With respect to the notes to the financial statements, the SEC is proposing to require a fund to describe the fund's use of swing pricing during the relevant reporting period, including the effects of swing pricing on the fund's financial statements.

Recordkeeping Requirements

Under the proposal, each fund would be required to comply with the following recordkeeping requirements:

- **Liquidity Risk Management Policies and Procedures.** These policies and procedures would have to be maintained for a period of five years, all in an easily accessible place.

- **Supplemental Materials.** Any materials provided to the board in connection with its initial approval as well as any material amendments to the program, would have to be maintained for a period of five years, the first two years in an easily accessible place.

- **Reports on Adequacy of the Program**. Reports on the adequacy of the program would have to be maintained for a period of at least five years, the first two years in an easily accessible place.

- **Three-Day Liquid Asset Minimum.** A written record of how a fund determined its three-day liquid asset minimum (and any amendments thereto) would have to be maintained for a period of not less than five years, the first two years in an easily accessible place.

- **Swing Pricing Policies and Procedures.** These policies and procedures would have to be maintained for a period of six years, all in an easily accessible place. A fund also would be required to keep a copy of all supporting documents regarding any adjustments to the fund's NAV as a result of its swing pricing policies and procedures for six years, the first two years in an easily accessible place.[60]

Compliance Dates

- **Liquidity Risk Management Program.** Based on a fund's asset size, the proposal sets forth a scaled compliance period. If the proposal is adopted, fund complexes that have net assets of $1 billion or more as of the most recent fiscal year would have 18 months to comply with the new rules. Fund complexes that have net assets below $1 billion would have an additional 12 months (*i.e.,* 30 months) to comply with proposed rule 22e-4.

- **Swing Pricing.** Since a fund's use of swing pricing would be optional, the SEC believes that a compliance period for this proposed rule is unnecessary.

- **Disclosure and Reporting Requirements.** All initial registration statement filings and post-effective amendments that are annual updates to effective registration statements would have to comply with the proposed amendments to Form N-1A within six months of the effective date of the proposal, if adopted. With respect to the proposed amendments to Form N-PORT, the compliance period would be the same as that for the liquidity risk management program requirements. Finally, the SEC proposes a compliance date of 18 months for all funds with respect to the proposed amendments to Form N-CEN.

[60] Such records would generally include, at a minimum, the fund's unswung NAV, the level of net purchases or net redemptions that the fund encountered (or estimated) that triggered the application of swing pricing, the swing factor that was used to adjust the fund's NAV and relevant data supporting this calculation.

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