SEC Adopts Rules to Require Liquidity Risk Management Programs, Permit Swing Pricing, and Modernize Information Reported by Funds

The Securities and Exchange Commission (the "SEC") voted last Thursday to adopt changes to enhance liquidity risk management by open-end funds, including mutual funds and exchange-traded funds ("ETFs"). These changes are designed to promote effective liquidity risk management across the open-end fund industry and will enhance disclosure regarding fund liquidity and redemption practices. The SEC also voted to adopt the swing pricing rule and changes to modernize and enhance the reporting and disclosure of information by registered investment companies.

The liquidity risk management rules are intended to reduce the risk that funds will not be able to meet shareholder redemptions and mitigate the potential dilution of fund shareholders' interests. These new rules will require mutual funds and ETFs to establish liquidity risk management programs that include multiple elements, including classifying the liquidity of the fund portfolio investments and implementing a highly liquid investment minimum. The rules also strengthen the 15 percent limit on illiquid investments by prohibiting funds from acquiring certain illiquid assets if they cause the fund to exceed this 15 percent limit and will require enhanced disclosure regarding fund liquidity and redemption practices.

The swing pricing rule will permit mutual funds to use swing pricing, which is the practice of adjusting a fund's net asset value to pass on the costs associated with purchasing or redeeming shares, including broker commissions and adjustments for market impact, to shareholders engaging in those activities.

The reporting modernization rules will enhance data reporting for mutual funds, ETFs and other registered investment companies by requiring funds to file a new monthly portfolio form (Form N-PORT) and a new annual reporting form (Form N-CEN). Forms N-PORT and N-CEN will be in a structured data format which will allow the SEC and the public to better analyze the information contained therein. The new rule will also require enhanced and standardized disclosures in financial statements and new disclosures in fund registration statements relating to a fund's securities lending activities.

The new rules and forms will be published on the SEC's website and in the Federal Register. Most funds would be required to comply with the liquidity risk management program requirements on December 1, 2018, and begin filing reports on new Forms N-PORT and N-CEN after June 1, 2018, while fund complexes with less than $1 billion in net assets would be required to comply with the liquidity risk management program requirements on, and to begin filing reports on Form N-PORT after, June 1, 2019. The effective date of the swing pricing rule is being delayed until 24 months after the adopting release is published in the Federal Register.

We will release a more detailed alert on these changes in the near future.

For More Information

To discuss any topic covered in this Client Alert, please contact a member of the Investment Management Group or visit us online at chapman.com.

Chapman and Cutler LLP

Attorneys at Law · Focused on Finance®