

# Special Report: Select Highlights of SEC Investment Company Liquidity Risk Management Programs Final Rulemaking

On October 13, 2016 the U.S. Securities and Exchange Commission (SEC) [voted unanimously](#) to approve final rules regarding [Investment Company Liquidity Risk Management Program](#) ("Final Rules") alongside new final rules concerning [Investment Company Reporting Modernization](#) and [Investment Company Swing Pricing](#). The Final Rules are the first finalized rules intended to address public sector concerns relating to liquidity risk management practices in the asset management industry. These concerns were described by recent global [Financial Stability Board](#) (FSB) and the U.S. [Financial Stability Oversight Council](#) (FSOC) consultations, as well as the [SEC proposal](#) that preceded the Final Rules.

The primary goal of the SEC's Final Rules is to mitigate "the risk that funds will be unable to meet their redemption obligations and mitigating dilution of the interests of fund shareholders." Among many other things, the Final Rules:

- Require funds to adopt and implement a written liquidity risk management program overseen by the fund's board and to limit investments in "illiquid assets" to 15% of net assets;
- Amend the proposed definition of "liquidity risk" by adding the phrase "without significant dilution of remaining investors' interests in the fund" in lieu of the proposed phrase "without materially affecting the fund's net asset value;"
- Amend the proposed "material affect" on price standard from the related proposal to a "significantly changing the market value" standard for the purpose of classifying assets by liquidity;
- Reduced number of asset liquidity classification buckets from the proposed six (6) to four (4) buckets based on how long it can be "reasonably expected" to sell and/or "convert to cash" (settle) the asset without "significantly changing the market value" based on "current market conditions."
  - (i) "[highly liquid](#)" assets are those that can be "converted to cash" within three (3) calendar days;
  - (ii) "[moderately liquid](#)" assets are those that can be "converted to cash" within three (3) and seven (7) calendar days;
  - (iii) "[less liquid](#)" assets are those that can be sold within seven (7) calendar days but "conversion to cash" is reasonably expected to occur in more than seven (7) days; and
  - (iv) "[illiquid](#)" assets are those that cannot be "reasonably expected to be sold without a significant change in price within seven (7) calendar days;"
- Changed the proposed position-level liquidity classifications to asset-class-level, unless market, trading, or investment-specific considerations with respect to a particular investment are expected to significantly affect the liquidity characteristics of a particular asset position;
- Require that a fund, and not the fund's board as proposed, determine the "highly liquid" investment minimum and reviewing this no less than annually this minimum; and
- Add a new (not proposed) Form N-LIQUID that would be confidentially submitted to the SEC within one business day after either the fund's level of "illiquid" assets exceeds 15 percent of its net assets or seven (7) consecutive days when its "highly liquid" investments fall below the fund's minimum for more than a brief period of time.

Compliance with the Final Rules will be required [December 1, 2018](#) for open-end management investment companies, including open-end ETFs, and June 1, 2019 for "smaller entities."

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