CARLTON FIELDS

# Implementation Delay and Q&As for Fund Liquidity Rule

March 31, 2018

On February 21, the SEC approved a six-month extension for mutual funds to comply with the classification (bucketing) requirements and related elements of its new liquidity rule. The extension was responsive to comments from the Investment Company Institute and others that fund vendors would not be ready to provide the necessary services by the deadline. The new compliance deadline for the rule's bucketing requirements is June 1, 2019 for fund complexes with more than $1 billion in assets, and December 1, 2019 for smaller firms. Also on February 21, the SEC staff issued 19 additional Q&As regarding compliance with the rule's requirements. In the new guidance, the staff confirmed previous indications that funds would enjoy significant flexibility in meeting classification requirements and testing for liquidity, but indicated there were limits to such flexibility. For example, the staff said:

- A17: funds may rely on a "reasonable framework" to identify exceptions to asset class classifications, ***but*** must conduct periodic testing of the framework.
- A21: funds are free to make reasonable assumptions regarding the investments they may choose to sell to meet redemptions, ***but*** a zero or near zero reasonably anticipated trading size would "not be a reasonable assumption."
- A23: funds of funds can focus on the liquidity of their underlying funds' shares without "looking through" to the underlying fund's investments, ***but*** may need to look through if there is "reason to believe" circumstances merit.
- A24: funds are not required to reclassify their investments on a daily basis, ***but*** "regular monitoring" is essential to compliance with the rule.
- A31: funds may limit pre-trade classifications to investments that the fund ***reasonably*** believes are likely to be illiquid, ***but*** should conduct periodic testing of the accuracy of the framework.

The staff's guidance reminds funds that regardless of any flexibility in methods, if a fund violates the

rule's 15 percent illiquid investment limit or the highly liquid investment minimum that the rule requires funds to establish, the fund would be required to report the violation to its board and to the SEC.

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