



SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 274

[Release No. IC-33046; File No. S7-04-18]

RIN 3235-AM30

Investment Company Liquidity Disclosure

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: The Securities and Exchange Commission is proposing amendments to its forms designed to improve the reporting and disclosure of liquidity information by registered open-end investment companies. The Commission is proposing a new requirement that funds disclose information about the operation and effectiveness of their liquidity risk management program in their annual reports to shareholders. The Commission in turn is proposing to rescind the current requirement in Form N-PORT under the Investment Company Act of 1940 that funds publicly disclose aggregate liquidity classification information about their portfolios, in light of concerns about the usefulness of that information for investors. In addition, the Commission is proposing amendments to Form N-PORT that would allow funds classifying the liquidity of their investments pursuant to their liquidity risk management programs required by rule 22e-4 under the Investment Company Act of 1940 to report on Form N-PORT multiple liquidity classification categories for a single position under certain specified circumstances. Finally, the Commission is proposing to add to Form N-PORT a new requirement that funds and other registrants report their holdings of cash and cash equivalents.

DATES: Comments should be received on or before [insert date 60 days after publication in Federal Register].

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/proposed.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-04-18 on the subject line; or

Paper Comments:

- 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 S7-04-18. 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 website (<http://www.sec.gov/rules/proposed.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 (the “Commission”) is proposing for public comment amendments to Form N-PORT [referenced in 17 CFR 274.150] under the Investment Company Act of 1940 [15 U.S.C. 80a-1 *et seq.*] (“Investment Company Act” or “Act”) and amendments to Form N-1A [referenced in 17 CFR 274.11A] under the Investment Company Act and the Securities Act of 1933 (“Securities Act”) [15 U.S.C. 77a *et seq.*].

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I. BACKGROUND

On October 13, 2016, the Commission adopted new rules and forms as well as amendments to its rules and forms to modernize the reporting and disclosure of information by registered investment companies (“funds”),¹ including information about the liquidity of funds’ portfolios.² In particular, the Commission adopted new Form N-PORT, which requires mutual funds and exchange traded funds (“ETFs”) to electronically file with the Commission monthly portfolio investment information on Form N-PORT, a structured data reporting form.³ On the same day, the Commission also adopted rule 22e-4, a new form, and related rule and form amendments to enhance the regulatory framework for liquidity risk management of funds.⁴ Among other things, rule 22e-4 requires a fund to classify each portfolio investment into one of four defined liquidity categories, sometimes referred to as “buckets.”⁵

¹ The term “funds” used in this release includes open-end management companies, including exchange-traded funds (“ETFs”) and excludes money market funds.

² Investment Company Reporting Modernization, Investment Company Act Release No. 32314 (Oct. 13, 2016) [81 FR 81870 (Nov. 18, 2016)] (“Reporting Modernization Adopting Release”). *See also* Investment Company Liquidity Risk Management Programs, Investment Company Act Release No. 32315 (Oct. 13, 2016) [81 FR 82142 (Nov. 18, 2016)] (“Liquidity Adopting Release”).

³ Registered money market funds and small business investment companies are exempt from Form N-PORT reporting requirements.

⁴ 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. *See* Liquidity Adopting Release, *supra* footnote 2.

⁵ 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, including, among others, the requirement that funds classify the liquidity of each of the fund’s portfolio investments into one of four defined liquidity categories: highly liquid investments, moderately liquid investments, less liquid investments, and illiquid

In connection with the liquidity classification requirement of rule 22e-4, a fund is also required to report confidentially to the Commission the liquidity classification assigned to each of the fund's portfolio investments on Form N-PORT.⁶ Each portfolio holding must be assigned to a single classification bucket. A fund must also publicly report on Form N-PORT the aggregate percentage of its portfolio investments that falls into each of the four liquidity classification categories noted above.⁷ This aggregate information would be disclosed to the public only for the third month of each fiscal quarter with a 60-day delay. Form N-PORT does not currently require funds to report the cash they hold.⁸

We designed rule 22e-4 and the related rules and forms to promote effective liquidity risk management throughout the fund industry and to enhance disclosure regarding fund liquidity and redemption practices.⁹ As discussed in detail below, since we adopted these requirements, Commission staff has engaged in extensive outreach with funds and other interested parties as they have sought to design the new systems and processes necessary to implement the new rules.

investments ("classification"). 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. Rule 22e-4 also requires funds to establish a highly liquid investment minimum, and includes requirements related to policies and procedures on redemptions in kind and evaluation of the liquidity of new unit investment trusts. Rule 22e-4 also includes other required elements, such as limits on purchases of illiquid investments, reporting to the board, and recordkeeping.

⁶ Item C.7 of Form N-PORT.

⁷ Item B.8.a of Form N-PORT. Form N-PORT also requires public reporting of the percentage of a fund's highly liquid investments that it has segregated to cover, or pledged to satisfy margin requirements in connection with, derivatives transactions that are classified as moderately liquid, less liquid, or illiquid investments. Item B.8.b of Form N-PORT.

⁸ Although the requirements of rule 22e-4 and Form N-PORT discussed above are in effect, the compliance date has not yet occurred. Accordingly, no funds are yet reporting this liquidity-related information on Form N-PORT. In another release issued earlier, among other things, we extended the current compliance date for certain classification-related provisions of rule 22e-4 and their associated Form N-PORT reporting requirements by six months. *See* Investment Company Liquidity Risk Management Programs; Commission Guidance for In-Kind ETFs, Investment Company Act Release No IC-33010; (Feb. 22, 2018) [83 FR 8342 Feb. 27, 2018)] ("Liquidity Extension Release").

⁹ *See* Liquidity Adopting Release, *supra* footnote 2, at n.112 and accompanying text.

As a complement to that engagement process, we have received letters¹⁰ raising concerns that the public disclosure of a fund’s aggregate liquidity classification information on Form N-PORT may not achieve our intended purpose and may confuse and mislead investors.¹¹ These letters detail the methodologies that fund groups are designing and implementing to conduct the liquidity classification, the disparate assumptions that underlie them, and the variability in classification that can occur as a result.¹² As we discuss further in section II.A below, these letters have caused us to question whether the current approach of disclosing aggregate liquidity fund profiles through Form N-PORT is the most accessible or useful way to facilitate public understanding of fund liquidity.¹³ Specifically, when the new rules take effect, the Commission will receive more granular position-level liquidity classification information and can request the fund’s methodologies and assumptions underlying their classification, while investors would have access only to the aggregate information on Form N-PORT without the necessary context. However, the Commission continues to believe, as it articulated when it adopted the final rule,

¹⁰ These letters (File No. S7-04-18) are available at <https://www.sec.gov/comments/s7-04-18/s70418.htm>.

¹¹ *See, e.g.*, Letter from SIFMA AMG to Chairman Jay Clayton, Commissioner Stein, and Commissioner Piwowar (Sept. 12, 2017) (“SIFMA AMG Letter”); Letter from Nuveen, LLC on Investment Company Liquidity Risk Management Programs (Nov. 20, 2017) (“Nuveen letter”) (urging the SEC not to publicly disclose the liquidity classification information submitted via new Form N-PORT); Letter from TCW to Chairman Jay Clayton, Commissioner Stein, and Commissioner Piwowar (Sept. 15, 2017) (“TCW Letter”).

¹² *See, e.g.*, Letter from the Investment Company Institute to The Honorable Jay Clayton (July 20, 2017) (“ICI Letter I”); Supplemental Comments on Investment Company Liquidity Risk Management Programs from the Investment Company Institute (Nov. 3, 2017) (“ICI Letter II”); Letter from Invesco Advisers, Inc. on Investment Company Liquidity Risk Management Programs (Nov. 8, 2017); Letter from Vanguard on Investment Company Liquidity Risk Management Programs (Nov. 8, 2017); Letter from John Hancock on Investment Company Liquidity Risk Management Programs (Nov. 10, 2017); Letter from T. Rowe Price Associates, Inc. on Investment Company Liquidity Risk Management Programs (Nov. 10, 2017); Letter from Federated Investors, Inc. on Liquidity Risk Management Rule 22e-4 (Feb. 6, 2018) (“Federated Letter”).

¹³ *See infra* text following footnote 18. Funds may also choose to provide additional context non-publicly to the Commission in the explanatory notes section (Part E of Form N-PORT).

that it is important for investors to receive information about a fund's liquidity, which can help investors better understand the risks they may be assuming through an investment in the fund.

In light of the comments we have received, we preliminarily believe that providing different information to investors via a different form would more effectively achieve the Commission's policy goal of promoting investor understanding of the liquidity risks of the funds in which they have invested, while minimizing risks of investor confusion. Accordingly, we are proposing to replace the requirement for a fund to publicly report to the Commission on Form N-PORT the aggregate liquidity portfolio classification information on a quarterly basis with new disclosure in the fund's annual shareholder report that provides a narrative discussion of the operation and effectiveness of the fund's liquidity risk management program over the reporting period.¹⁴

Second, we are proposing additional amendments to Form N-PORT that would allow a fund to report a single portfolio holding in multiple classification buckets under certain defined circumstances. Currently, a fund is required to choose only one classification bucket, even in circumstances where splitting that holding up into multiple classification buckets may better reflect the actual liquidity characteristics of that position. We believe that permitting funds to split a single portfolio holding into multiple buckets under circumstances where we believe that such reporting would be more or equally accurate, and in some cases less burdensome, would provide us with equal or better information at lower cost to funds (and thus, to fund shareholders).

¹⁴ As discussed below, we also are proposing a related change to make non-public (but not eliminate) the disclosure required under Item B.8 of Form N-PORT about the percentage of a fund's highly liquid investments segregated to cover or pledged to satisfy margin requirements in connection with certain derivatives transactions, given that this information is only relevant when viewed together with full liquidity classification information.

Third, we are proposing to require funds and other registrants¹⁵ to report holdings of cash and cash equivalents on Form N-PORT so that we may monitor trends in the use of cash and cash equivalents and, in the case of funds, more accurately assess the composition of a fund's highly liquid investment minimum ("HLIM").

II. DISCUSSION

A. Proposed Amendments to Liquidity Public Reporting and Disclosure Requirements

Today we are proposing to replace the requirement in Form N-PORT that a fund publicly disclose on an aggregate basis the percentage of its investments that it has allocated to each liquidity classification category with a new narrative discussion in the fund's annual report regarding its liquidity risk management program. The narrative discussion would include disclosure about the operation and effectiveness of the fund's implementation of its required liquidity risk management program during the most recently completed fiscal year.¹⁶ A fund already is required to disclose a summary of the principal risks of investing in the fund, including liquidity risk if applicable, in its prospectus.¹⁷ Therefore, in combination, these disclosures will provide new and existing investors with information about the expected liquidity risk of the fund and ongoing disclosure to existing shareholders (and to new investors to the extent that they have access to annual reports) regarding how the fund continues to manage that risk, along with other factors affecting the fund's performance. This revised approach is designed to provide

¹⁵ The term "registrants" refers to entities required to file Form N-PORT, including all registered management investment companies, other than money market funds and small business investment companies, and all ETFs (regardless of whether they operate as UITs or management investment companies). *See* rule 30b1-9.

¹⁶ *See* proposed amendments to Item B.8 of Form N-PORT and proposed Item 27(b)(7)(iii) of Form N-1A.

¹⁷ *See* Item 4(b) of Form N-1A. In addition, Item 9(c) of Form N-1A requires a fund to disclose all principal risks of investing in the fund, including the risks to which the fund's particular portfolio as a whole is expected to be subject and the circumstances reasonably likely to affect adversely the fund's net asset value, yield, or total return.

accessible and useful disclosure about liquidity risk management to investors, with appropriate context, so that investors may understand its nature and relevance to their investments.

1. Concerns with Public Aggregate Liquidity Profile

As noted above, since the Commission adopted rule 22e-4 and the related rule and form amendments, Commission staff has engaged extensively with interested parties regarding progress toward implementation. As a complement to that engagement process, we have received letters from industry participants discussing the complexities of the classification process.¹⁸ These commenters raised three general types of concerns that informed this proposal's revised approach to public fund liquidity-related disclosure. First, commenters described how variations in methodologies and assumptions used to conduct liquidity classification can significantly affect the classification information reported on Form N-PORT in ways that investors may not understand ("subjectivity"). Second, the commenters suggested that Form N-PORT may not be the most accessible and useful way to communicate information about liquidity risk and may not provide the necessary context for investors to understand how the fund's classification results relate to its liquidity risk and risk management ("lack of context"). Third, the commenters argued that because this reporting item on Form N-PORT singles out liquidity risk, and does not place it in a broader context of the risks and factors affecting a fund's risk, returns, and performance, it may inappropriately focus investors on one investing risk over others ("liquidity risk in isolation"). Below we discuss these considerations — and why we preliminarily believe the proposed revisions to disclosure requirements on Form N-1A address these concerns while satisfying our public disclosure goals,

¹⁸

See supra footnotes 10-12.

including the need to provide shareholders and other users with improved information about funds' liquidity risk profile.¹⁹

Subjectivity

Commenters emphasized that classification is a subjective process.²⁰ It is based on underlying data, assumptions, measurement periods, and complex statistical algorithms that can vary significantly. Accordingly, different managers classifying the same investment may vary in the way they weigh these factors and come to different classification conclusions, which would be consistent with our intent in adopting the rule.²¹

Commenters stated, however, that presenting liquidity classification information in a standard format — as the final rule requires — inaccurately implies to investors that the classifications for all funds were formed through a uniform process and that the resulting classifications would be comparable across funds.²² Commenters suggested that, because of the lack of such uniformity of classification, using a fund's liquidity profile to make comparisons between funds may mislead investors and could lead to investors basing investment decisions on

¹⁹ See Liquidity Adopting Release, *supra* footnote 2, at text following n.626.

²⁰ See, e.g., TCW Letter (stating that many different managers weighing different factors and using disparate data can result in different liquidity classification results across managers for the same security). See also SIFMA AMG Letter.

²¹ See Liquidity Adopting Release, *supra* footnote 2, at n. 596 and accompanying text. (“We recognize that liquidity classifications, similar to valuation- and pricing-related matters, inherently involve judgment and estimations by funds. We also understand that the liquidity classification of an asset class or investments may vary across funds depending on the facts and circumstances relating to the funds and their trading practices.”).

²² See, e.g., SIFMA AMG Letter. We note that in the Liquidity Adopting Release, we considered certain proposed uniform approaches to liquidity classification that would have less subjective inputs, and discussed why we believed that the approach we adopted most effectively achieves our goals. This is in part because such approaches that do not include subjective inputs may not have resulted in liquidity classification data that is informed by fund advisers' actual trading experience. See, e.g., Liquidity Adopting Release, *supra* footnote 2, at section III.C.

inappropriate grounds.²³

Commenters suggested that this subjectivity and seeming appearance of uniformity in content may have a variety of other pernicious effects. For example, commenters suggested investors may, in choosing between two funds that have similar investment objectives, pick the fund that appears to have more highly liquid investments (and potentially, thereby, a lower liquidity risk) without understanding the subjectivity that underlies the classification process.²⁴ As a result, the public disclosure of liquidity profiles may provide funds an incentive to classify their securities as more liquid in order to make their funds appear more attractive to investors, further increasing the risk of investor confusion.²⁵ Such incentive to classify assets as more liquid, if widespread, could undermine the Commission's objectives for the fund's proper management of its liquidity risks through its liquidity risk management program and its monitoring efforts. One commenter also suggested that the size of the fund may have disproportionate effects on its liquidity classification results, and thus the fund's overall aggregate liquidity profile.²⁶ As a result, they argued that investors may be confused by, or

²³ See SIFMA AMG Letter and Nuveen Letter. See also Kristin Grind, Tom McGinty, and Sarah Krouse, *The Morningstar Mirage*, THE WALL STREET JOURNAL, (Oct. 25, 2017), available at <https://www.wsj.com/articles/the-morningstar-mirage-1508946687> (discussing issues with investors basing investing decisions on evaluations of funds without necessarily understanding the bases of those evaluations or their limitations).

²⁴ See TCW Letter (“Investors could flock to more apparently liquid funds, only to discover too late that classifications did not actually provide comparable liquidity data”); see also Nuveen Letter (“[T]he classification information that will be reported via Form N-PORT may lead the public to draw inappropriate conclusions about a fund's liquidity. . . . [I]nvestors, intermediaries, and financial advisers may be misled as to the value of such information, and use it as the basis for investment decisions despite this lack of understanding.”).

²⁵ See SIFMA AMG Letter. We acknowledged in the Liquidity Adopting Release that the classification status of a security “inherently involve[s] judgment and estimations by funds” and that “the liquidity classification of an asset class or investments may vary across funds depending on the facts and circumstances relating to the funds and their trading practices.” See Liquidity Adopting Release, *supra* footnote 2, at text accompanying n.596.

²⁶ See ICI Letter II, at Appendix C.

unaware of the causes of, the differences in results between large and small portfolios' liquidity profiles, and may inappropriately believe that smaller portfolios have less liquidity risk.²⁷

Lack of Context

Commenters suggested that the format of the Form N-PORT disclosure does not give funds the opportunity to explain to the public the underlying assumptions for their classification, nor can they tailor the disclosure to their specific risks. One commenter asserted that, because the aggregate liquidity profile is to be reported on Form N-PORT, the information will only be understandable by sophisticated users or intermediaries.²⁸ They argued that for investors to have a sufficient understanding of the role classification plays in a fund's liquidity risks, investors need contextual information regarding the underlying subjective assumptions and methodologies used by the fund in its classification process.²⁹ They noted that Form N-PORT does not provide context or additional information that would help investors understand the assumptions and

²⁷ ICI Letter II (providing a liquidity analysis of a variety of investments, which found that smaller portfolios nearly always appeared to have a highly liquid aggregate profile, while larger portfolios holding the same positions appeared to have a less liquid profile).

²⁸ SIFMA AMG Letter (asserting that Form N-PORT aggregate classification disclosure puts less sophisticated investors at a disadvantage because “[u]nlike securities traded in the secondary markets, in which all market participants can be expected to benefit from publicly available information through the efficient market pricing mechanism, mutual fund shares are purchased and sold directly with the fund at net asset value per share. Thus, there is no automatic market mechanism for sophisticated investors’ superior understanding of the liquidity information and its limitations to be transmitted to less sophisticated investors.”).

²⁹ *See generally* SIFMA AMG Letter (arguing that the classification process “relies heavily on judgments from portfolio managers and others, based on predictions and extrapolation of data, which are then combined with other judgments from other sources based on similar assumptions . . . For the investing public, which will see only quarterly percentages 60 – 151 days after the fact [on Form N-PORT], without context or explanation, this information will be at best meaningless and more likely misleading.”); *see also* Nuveen Letter (similarly arguing that classification information that will be reported via Form N-PORT may lead the public to draw inappropriate conclusions about a fund's liquidity and that this information “will also be inherently subjective, as the classification process relies heavily on judgments from portfolio managers and other sources based on a series of assumptions that may vary among firms and even within firms.”).

methodologies used for liquidity-related information.³⁰

Liquidity Risk in Isolation

One commenter also suggested that the information publicly disclosed on Form N-PORT singles out liquidity risk, and that focusing on liquidity risk in isolation, presented through an unexplained aggregate liquidity profile of a fund, may encourage investors to focus overly on liquidity risk, compared to other risks that may be far more important to their long-term investment goals.³¹ An investor choosing between two funds with comparable investment objectives and performance may choose a fund that appears to have more highly liquid investments, without adequately considering other risks of their investment and how they relate to liquidity risk. For example, an isolated focus on liquidity risk may result in investors not evaluating whether such a fund is achieving comparable performance despite maintaining low-yielding assets through use of derivatives or other leverage, and whether the investor is comfortable with the trade-off of liquidity versus leverage risks.

2. *New Approach to Liquidity Risk Disclosure*

We continue to believe it is important for investors to understand the liquidity risks of the funds they hold and how those risks are managed. However, we appreciate commenters' concerns that public dissemination of the aggregate classification information, without an accompanying explanation to investors of the underlying subjectivity, methodological decisions, and assumptions that shape this information, and other relevant context, may be potentially

³⁰ SIFMA AMG Letter. This commenter also noted that because the aggregate liquidity profile would be a backward looking review of a fund's liquidity presented only quarterly, with a 60 day delay, it may be inappropriate and misleading if investors were to base investing decisions on this information without being provided context about its potential staleness.

³¹ SIFMA AMG Letter (concerned that the focus on liquidity risk in isolation would encourage investors to exaggerate the importance of liquidity risk relative to other risks that may be far more important to their long-term investment goals.).

misleading to investors.³² As discussed above, in light of the variability of the classification process under rule 22e-4, we do not believe it is appropriate to adapt Form N-PORT to provide the level of detail and narrative context necessary for investors to effectively appreciate the fund's liquidity risk profile.³³ We also believe that it may take significant detailed disclosure and nuanced explanation to effectively inform investors about the subjectivity and limitations of aggregate liquidity classification information so as to allow them to properly make use of the information. Such lengthy disclosure may not be the most accessible and useful way to accomplish the Commission's goals. To the extent that such disclosure would need to be granular and detailed to effectively explain the process, it may also not be consistent with the careful balancing of investor interests that the Commission performed in determining to require disclosure of sensitive granular information, including position-level data, only on a non-public basis.³⁴

We also appreciate how the public dissemination of the aggregate classification information could create perverse incentives to classify investments as more liquid, and may inappropriately single out liquidity risk compared to other risks of the fund. Additionally, we are concerned that disclosing funds' aggregate liquidity profile may potentially create risks of

³² The Commission has access to the more granular position-level liquidity classification information as well as funds' methodologies and assumptions, and thus does not face these same challenges in interpreting the classification data.

³³ We believe that due to the variability and subjective inputs required to engage in liquidity classification under rule 22e-4, providing effective information about liquidity classifications under that rule to investors poses difficult and different challenges than the other data that is publicly disclosed on Form N-PORT, which is more objective and less likely to vary between funds based on their particular facts and circumstances.

³⁴ As discussed in the Liquidity Adopting Release, we determined that liquidity classification data on individual securities was necessary for our monitoring efforts, but not appropriate or in the public interest to be disclosed to investors or other market participants in light of the inherent variability of the classification process and the potential for predatory trading using such granular information." See Liquidity Adopting Release, *supra* footnote 2, at text accompanying nn.613-615.

coordinated investment behavior, if, for example, funds were to create more correlated portfolios by purchasing investments that they believed third parties, such as investors or regulators, may view as “more liquid.”³⁵ Such risks may both increase the possibility of correlated market movements in times of stress, and may potentially reduce the utility of the classification data reported to us. We now preliminarily believe that effective disclosure of liquidity risks may be better achieved through another disclosure vehicle, rather than Form N-PORT, which would not present the potential drawbacks discussed above.

Accordingly, as discussed previously, we are proposing to replace the requirement for funds to disclose their aggregate liquidity profile on a quarterly basis on Form N-PORT with a new requirement for funds to discuss briefly the operation and effectiveness of a fund’s liquidity risk management program in the fund’s annual report to shareholders, as part of its management discussion of fund performance (“MDFP”).³⁶ This disclosure would complement existing liquidity risk disclosure that funds provide in their prospectus (if it is a principal investment risk of the fund).

The proposed amendments to Form N-1A would require funds to “briefly discuss the operation and effectiveness of the Fund’s liquidity risk management program during the most recently completed fiscal year.”³⁷ To satisfy this requirement, a fund generally should provide information about the operation and effectiveness of the program, and insight into how the program functioned over the past year.³⁸ This discussion should provide investors with enough detail to

³⁵ See ICI Letter I.

³⁶ Proposed Item 27(b)(7)(iii) of Form N-1A.

³⁷ Proposed Item 27(b)(7)(iii) of Form N-1A.

³⁸ We considered whether to require funds to disclose specific elements of their liquidity risk management program, but we believe that such a requirement would unnecessarily limit the fund’s ability to provide the appropriate level of context it believes necessary for investors to understand the fund’s liquidity risks. We

appreciate the manner in which a fund manages its liquidity risk, and could, but would not be required to, include discussion of the role of the classification process, the 15% illiquid investment limit, and the HLIM in the fund's liquidity risk management process.³⁹

For example, as part of this new disclosure, a fund might opt to discuss the particular liquidity risks that it faced over the past year, such as significant redemptions, changes in the overall market liquidity of the investments the fund holds, or other liquidity risks, and explain how those risks were managed and addressed, and whether those risks affected fund performance. If the fund faced any significant liquidity challenges in the past year, it could opt to discuss how those challenges affected the fund and how they were addressed. Funds may also wish to provide context and other supplemental information about how liquidity risk is managed in relation to other investing risks of the fund. We note that this new disclosure would not require a fund to disclose any specific classification information, either security specific or in the aggregate, although a fund could do so if it wished. Also, consistent with the current rule, it would not require a fund to disclose publicly the level of its HLIM, any shortfalls or changes to it, or any breaches of the 15% illiquid investment limit.⁴⁰ We expect that this disclosure should

believe that a principles-based approach to this disclosure requirement would better achieve our goal of promoting investor understanding of fund liquidity risks, without risking investor confusion. Furthermore, we believe that a principles-based approach, rather than a prescriptive one, will give a fund the flexibility to disclose its approach to liquidity risk management in a manner most appropriate for the fund as part of its broader discussion of the fund's risks without placing undue emphasis on liquidity risks. We also believe that the approach we are proposing today is less likely to result in standardized boilerplate disclosure because it will allow funds to tailor disclosure to their particular liquidity risks and how they manage them.

³⁹ We note that rule 22e-4(b)(2)(iii) requires a fund board to review, no less frequently than annually, a report prepared by the program administrator that addresses the operation of the program over the last year and its adequacy and effectiveness. Because funds will already need to prepare a report on the program for these purposes, we expect that the disclosure requirement we are proposing today would be unlikely to create significant additional burdens as the conclusions in this report may be largely consistent with the overall conclusions disclosed to investors in the annual report.

⁴⁰ Under rule 22e-4 and related rules and forms, funds are not required to publicly disclose any shortfalls or changes to their HLIM or breaches of the 15% illiquid investment limit.

allow funds to provide context and an accessible and useful explanation of the fund's liquidity risk in relation to its management practices and other investment risks as appropriate.

Because the proposal would eliminate public disclosure of a fund's aggregate liquidity classification information, we would also re-designate reporting about the percentage of a fund's highly liquid investments that are segregated to cover, or pledged to satisfy margin requirements in connection with, derivatives transactions that are classified as Moderately Liquid Investments, Less Liquid Investments and Illiquid Investments to the non-public portion of the Form.⁴¹ We believe public disclosure of this percentage of a fund's highly liquid investments would be of limited to no utility to investors without broader context and, therefore, may be confusing. However, we believe that funds should report this item to us on a non-public basis because we would otherwise be unable to determine the percentage of a fund's highly liquid investments that is actually unavailable to meet redemptions.⁴²

We believe that these proposed amendments will provide effective disclosure that better informs investors of how the fund's liquidity risk and liquidity risk management practices affect their investment than the current Form N-PORT public liquidity risk profile.⁴³ The annual report

⁴¹ We are proposing to do this by renumbering current Item B.8.b of Form N-PORT as Item B.8 and making this item non-public. This item requires public reporting of the percentage of a fund's highly liquid investments that it has segregated to cover, or pledged to satisfy margin requirements in connection with, derivatives transactions that are classified as moderately liquid, less liquid, or illiquid investments. Item B.8.b of Form N-PORT. We originally required this disclosure in order to avoid misleading investors about the actual availability of investments that are highly liquid investments to meet redemptions. *See* Liquidity Adopting Release, *supra* footnote 2, at n.623 and accompanying text.

⁴² For these reasons, we find that it is neither necessary nor appropriate in the public interest or for the protection of investors to make this reporting about the percentage of a fund's highly liquid investments that is segregated to cover less liquid derivatives transactions publicly available.

⁴³ As an alternative to this new proposed narrative disclosure requirement, we considered moving the aggregate liquidity profile from Form N-PORT to the fund's annual report, which might allow funds to provide additional context and explanation of their methodology. However, we believe that such an approach might not address the concerns discussed above, as investors may still use the liquidity profile to compare funds despite its inherent subjectivity and variability.

disclosure provides a fund the opportunity to tailor its disclosure to the fund's specific risks. This would provide funds the opportunity to explain the level of subjectivity involved in liquidity assessment, and give a narrative description of these risks and how they are managed within the context of the fund's own investment strategy. This annual report disclosure should provide funds the ability to give sufficient context on these risks, in a way that the current Form N-PORT liquidity disclosure does not.

In addition, because funds deliver annual reports to their shareholders each year, the annual report may be a better vehicle for certain existing investors to gain access to liquidity risk information if they prefer to base their decisions partially on information delivered to them, versus information that they would need to seek out on Form N-PORT, whether directly from the Commission or via a third party service.⁴⁴ Moreover, third party services, in repackaging this information, may potentially use additional assumptions about the value or proper presentation of liquidity profiles, thereby introducing further subjectivity and variability about which investors may not be aware.⁴⁵ The proposed annual report disclosure also would allow a fund to discuss liquidity risk as one among several risks, and does not require funds to provide any security or portfolio specific classification information. As a result, liquidity risk should not be

⁴⁴ Although investors would be provided liquidity information only annually under our proposal (rather being able to access it quarterly through Form N-PORT), as discussed above we believe that investors may be more likely to access and appreciate liquidity information provided in the context of the annual report, rather than seeking out liquidity information on Form N-PORT or through third parties. Accordingly, we believe that the annual report is a more appropriate venue for providing liquidity information, even though it is updated less frequently than Form N-PORT.

⁴⁵ We recognize that third party service providers who provide tools that assist funds engaging in the classification process may have some insight into the methodologies and assumptions used by the funds they service which, if they were to repackage and distribute fund liquidity profile data, may allow them to provide context about such information. However, these service providers also may provide public information about funds they do not service, even if their insight into classification methodologies and assumptions may be inapplicable to these funds. Further, even when a third party service provider does assist a fund, that fund may not share all of the assumptions and methods that it ultimately uses in classification with its service provider, further limiting the utility of any such insight in providing context about the variability and lack of comparability of fund liquidity profiles.

inappropriately singled out among the other risks of the fund. Finally, because many funds deliver annual reports in conjunction with an annual delivery of the summary prospectus, investors may be able to evaluate the summary of the principal risks of investing in the fund contained in the summary prospectus, including liquidity risk if applicable, in conjunction with the liquidity risk management program disclosure we are proposing to include in the annual report. This may facilitate a more comprehensive understanding of the fund's liquidity risks and its management of these risks for investors.

To further assist in providing investors with information about fund liquidity, the staff anticipates that publishing aggregated and anonymized information about the fund industry's liquidity may be beneficial. We note that, since October 2015, Commission staff has published a periodic report that contains highly-aggregated and anonymized private fund industry statistics derived from Form PF data. This staff report is designed to enhance public understanding of the private fund industry and facilitate Commission staff participation in meetings and discussions with industry professionals, investors, and other regulators.⁴⁶ Publishing a similar staff report on the aggregated liquidity of funds may provide similar benefits as the Form PF report. We expect that the staff would publish the report periodically and that the report would discuss aggregated and anonymized liquidity data of all funds or funds in certain categories, but would not identify the specific liquidity profile of any individual fund. Staff from the Division of Investment Management as well as staff from the Division of Economic and Risk Analysis have also

⁴⁶ See Annual Staff Report Related to the Use of Form PF Data, *available at* <https://www.sec.gov/files/im-private-fund-annual-report-101617.pdf>.

published ad hoc papers on data drawn from Form PF to help inform the public as to the staff's analyses of that data. We would anticipate a similar approach to the fund liquidity data.⁴⁷

In addition to interim public reporting of aggregate, anonymized liquidity information, staff from the Divisions of Investment Management and Economic and Risk Analysis will conduct a review of the granular fund-specific liquidity classification data that the Commission will begin receiving on a confidential basis in June 2019.⁴⁸ The staff will provide an analysis of the data to the Commission and present to the Commission by June 2020 a recommendation addressing whether and, if so, how there should be public dissemination of fund-specific liquidity classification information.

Finally, in its 2017 Asset Management and Insurance Report, the Department of Treasury highlighted the importance of robust liquidity risk management programs, but recommended that the Commission embrace a “principles-based approach to liquidity risk management rulemaking and any associated bucketing requirements.”⁴⁹ Today, we are proposing to modify certain aspects of our liquidity framework. We note that market participants will continue to gather insights as liquidity risk management programs are implemented, and can provide comments to the Commission as they do so. The staff will monitor the information received and report to the Commission what steps, if any, the staff recommends in light of commenter experiences.

⁴⁷ See Liquidity Adopting Release, *supra* footnote 2, at n.617 and accompanying text; see also Investment Company Reporting Modernization, Investment Company Act Release No. 32936 (Dec. 8, 2017) [82 FR 58731 (Dec. 14, 2017)] at text accompanying nn.13-15.

⁴⁸ See Liquidity Extension Release *supra* footnote 8.

⁴⁹ See A FINANCIAL SYSTEM THAT CREATES ECONOMIC OPPORTUNITIES; ASSET MANAGEMENT AND INSURANCE, U.S. Department of the Treasury, Oct. 2017 available at https://www.treasury.gov/press-center/press-releases/Documents/A-Financial-System-That-Creates-Economic-Opportunities-Asset_Management-Insurance.pdf.

3. *Comment Request*

We request comment on the proposed elimination of the aggregate liquidity profile public disclosure requirement of Form N-PORT and our proposed replacement with a requirement that funds discuss the operation and effectiveness of their liquidity risk management program as part of their annual reports to shareholders.

- Should we eliminate this public disclosure of funds' aggregate liquidity profiles?
Why or why not?
- To what extent would investors have relied on a fund's aggregate liquidity profile in making investment decisions? Is it likely that this disclosure would have been informative rather than confusing to investors in making these decisions?
- If, as proposed, we were to eliminate the requirement that funds publicly disclose their aggregate liquidity profile, would investors have sufficient information about a fund's liquidity risk to make an informed investment decision?
- Should we retain the public disclosure of a fund's aggregate liquidity profile and otherwise seek to address the concerns discussed above? For example, would making the disclosure more frequent (*i.e.*, monthly), reducing the lag on public disclosure, providing funds the opportunity to publicly provide additional context and explanation on the Form or elsewhere, or other changes address the concerns discussed above? Should we permit funds to choose to make any explanatory notes related to liquidity disclosures in Part E of Form N-PORT publicly available?
- Instead of eliminating the public disclosure of a fund's aggregate liquidity profile as proposed, should we instead make the profile non-public for some additional

period of time (*e.g.*, 2 to 3 years) to allow us to evaluate the quality of the information provided and its potential impact on investors?

- Should we make current Item B.8.b of Form N-PORT (highly liquid investments segregated to cover less liquid derivatives) non-public as proposed? If it was retained as public, would investors understand it without accompanying classification information? Alternatively, should we rescind the requirement entirely?
- Should we require a fund to provide a discussion of the operation and effectiveness of its liquidity risk management program, as we are proposing? Why or why not? Should we instead require disclosure about the extent to which and the manner in which the fund took liquidity risk and managed liquidity risk during the period in question and how those risks and management affected fund performance?
- As part of this proposed disclosure, should we require a fund to discuss specific elements of the fund's liquidity risk program such as the 15% illiquid investment limit, HLIM, classification process or specific liquidity risk observations? Why or why not?
- Should we require a fund to include a discussion of any relevant changes made to its liquidity risk management over the course of the reporting period?
- What additional information would be relevant to investors regarding liquidity risks that we should require funds to disclose?
- Should we require this liquidity risk disclosure to be included in the annual report? Should it instead be included in another disclosure document such as the

fund's statutory prospectus, summary prospectus, or statement of additional information? If so, under what item should it be included?

- Are there alternative approaches to providing relevant liquidity information to investors? If so, what are they, and why should we use them?
- Are there advantages to the approach that Treasury recommends? If so, what additional steps, if any, should we consider to shift toward a principles-based approach? To what extent have funds already implemented the existing liquidity classification requirement?

B. Proposed Amendments to Liquidity Reporting Requirements

We are also proposing to make certain changes to Form N-PORT related to the liquidity data reported on Form N-PORT. As discussed below, we believe these changes enhance the liquidity data reported to us. In addition, for some funds, these proposed changes may also reduce cost burdens as they comply with the rule.

1. Multiple Classification Categories

We are proposing amendments to Form N-PORT to allow funds the option of splitting a fund's holding into more than one classification category in three specified circumstances.⁵⁰ Today, Form N-PORT requires a fund to classify each holding into a single liquidity bucket. The staff has engaged in discussions with funds regarding questions that have arisen in implementing the liquidity rule and related requirements. These discussions have led us to propose these changes today.

First, some funds have explained that the requirement to classify each entire position into one classification category poses difficulties for certain holdings and may not accurately reflect

⁵⁰ See proposed Item C.7.b of Form N-PORT and Instructions.

the liquidity of that holding. In these cases, even though the holding may nominally be a single security, different liquidity-affecting features may justify the fund treating the holding as two or more separate investments for liquidity classification purposes (“differences in liquidity characteristics”). For example, a fund might hold an asset that includes a put option on a percentage (but not all) of the fund’s holding of the asset.⁵¹ Such a feature may significantly affect the liquidity characteristics of the portion of the asset subject to the feature, such that the fund believes that the two portions of the asset should be classified into different buckets.⁵²

Second, some funds suggested that in cases of sub-advisers managing different portions or “sleeves” of a fund’s portfolio, differences may arise between sub-advisers as to their views of the liquidity classification of a single holding that may be held in multiple sleeves. They noted it would avoid the need for costly reconciliation — and may provide useful information to the Commission on each sub-adviser’s determination about the asset’s liquidity — to be able to report each sub-adviser’s classification of the proportional holding it manages instead of putting the entire holding into a single category.⁵³

Finally, some funds indicated that for internal risk management purposes they currently classify their holdings proportionally across buckets, based on an assumed sale of the entire

⁵¹ For example, if 30% of a holding is subject to a liquidity feature such as a put, and the other 70% is not, pursuant to the proposed Instructions to Item C.7 of Form N-PORT, a fund may split the position, evaluate the sizes it reasonably anticipates trading for each portion of the holding that is subject to the different liquidity characteristics, and classify each separate portion differently, as appropriate. The fund in such a case would use the classification process laid out in the final rule, but would apply it separately to each portion of the holding that exhibits different liquidity characteristics.

⁵² As another example, a fund might have purchased a portion of an equity position through a private placement that makes those shares restricted (and therefore illiquid) while also purchasing additional shares of the same security on the open market. In that case, certain shares of the same holding may have very different liquidity characteristics depending on the specific shares being evaluated.

⁵³ Similar to the “differences in liquidity characteristics” examples discussed above, under the proposed amendments to the liquidity classification reporting on Form N-PORT the fund effectively would be treating the portions of the holding managed by different sub-advisers as if they were two separate and distinct securities, and bucketing them accordingly. *See* Instructions to Item C.7 of Form N-PORT.

position (“proportionality”).⁵⁴ In such cases, they argued that allowing a fund to have the option of proportionally reporting the position on Form N-PORT would be more efficient and less costly.⁵⁵ We believe that in such cases, this form of reporting would not impair the Commission’s monitoring and oversight efforts as compared to our approach of classifying based on “sizes that the fund would reasonably anticipate trading.”⁵⁶ Further, we believe the approach we are proposing today, which allows, but does not require, funds to use the proportionality approach in specified circumstances, would maintain the quality of the information reported to us and be potentially less costly than either our previously proposed or adopted approaches.⁵⁷

We agree that we should permit funds to report liquidity classifications in these ways as they may equally, or more accurately, reflect their liquidity and in some cases may be less

⁵⁴ We initially proposed to require that funds classify each portfolio position based on the amount of time it would take to convert the entire position, or portions thereof, to cash (“proportionality approach”). *See* Open-End Fund Liquidity Risk Management Programs; Swing Pricing; Re-Opening of Comment Period for Investment Company Reporting Modernization Release, Investment Company Act Release No. 31835 (Sept. 22, 2015) [80 FR 62274 (Oct. 15, 2015)], at n.172 and accompanying text. Multiple commenters expressed concern about the proposed requirement, arguing, among other things, that a fund generally would not need to liquidate an entire large position unexpectedly. Rule 22e-4 as adopted, requires a fund, when classifying an investment, to instead determine whether trading varying portions of a position in a particular portfolio investment, in sizes that the fund would reasonably anticipate trading, is reasonably expected to significantly affect the liquidity characteristics of that investment (*i.e.*, market-depth). These market-depth considerations were adopted as a substitute for the proposed proportionality approach. *See* Liquidity Adopting Release, *supra* footnote 2, at n.439 and accompanying text.

⁵⁵ Effectively, these funds requested the option to use the position size bucketing approach that was originally proposed (analyzing the entirety of a fund’s position and splitting it among buckets), rather than bucketing the entire holding into a single category based on the sizes they reasonably anticipate trading, as required under the final rule.

⁵⁶ Under the proposed Instructions to Item C.7 of Form N-PORT, a fund taking the proportionality approach would use a method similar to that described in the proposal, and split the entire holding among the four classification categories. For example, a fund holding \$100 million in Asset A could determine that it would be able to convert to cash \$30 million of it in 1-3 days, but could only convert the remaining \$70 million to cash in 3-7 days. This fund could choose to split the liquidity classification of the holding on Form N-PORT and report an allocation of 30% of Asset A in the Highly Liquid category and 70% of Asset A in the Moderately Liquid category. Such a fund would not use sizes that it reasonably anticipates trading when engaging in this analysis, but instead would assume liquidation of the whole position.

⁵⁷ As discussed in the economic analysis below, allowing classification in multiple categories may be less costly if it better aligns with current fund systems or allows funds to avoid incurring costs related to the need to develop systems and processes to allocate each holding to exactly one classification bucket.

burdensome. In addition, we believe that allowing funds to proportionally report the liquidity classification of securities under the three circumstances we discussed here will enhance our monitoring efforts, as it will allow for a more precise view of the liquidity of these securities. Because funds that choose to classify across multiple categories under this approach would be required to indicate which of the three circumstances led to the split classification, we will be able to monitor more effectively the liquidity of a fund's portfolio and determine the circumstances leading to the classification. Therefore, we are proposing to amend Item C.7 of Form N-PORT to provide funds the option of splitting the classification categories reported for their investments on a percentage basis, if done for one of these three reasons.⁵⁸ We are also proposing new Instructions to Item C.7 that explain the specified circumstances where a fund may split classification categories. In addition, we are proposing new Item C.7.b, which would require funds taking advantage of the option to attribute multiple classifications to a holding to note which of the three circumstances led the fund to split the classifications of the holdings.⁵⁹

We seek comment on our proposal to allow, but not require, funds to classify a single holding in multiple categories on Form N-PORT.

- Should we allow funds to split holdings among different liquidity categories in three specified circumstances as we are proposing today?⁶⁰ Why or why not?

⁵⁸ Proposed revisions to Item C. 7 and its Instructions of Form N-PORT. Funds that choose not to take advantage of this proportional splitting approach may continue to use the approach laid out in the final rule of bucketing an entire position based on the liquidity of the sizes the fund would reasonably anticipate trading.

⁵⁹ Proposed Item C.7.b of Form N-PORT. A fund may also choose to provide (but is not required to) additional context on its process for classifying portions of the same holding differently in the explanatory notes section of Form N-PORT. *See* Part E of Form N-PORT.

⁶⁰ Proposed Instructions to Item C.7 to Form N-PORT.

- Should we require funds to use a consistent approach to classification for all of their investments for purposes of Form N-PORT reporting? For example, should we require a fund that attributes multiple classifications for a holding because it uses a full liquidation analysis on one position to do so consistently for all of its positions?
- Are there circumstances other than the ones discussed in the proposed Form N-PORT Instructions to Item C.7 when funds may wish to classify the same security into multiple categories? If so, what are they and why should we permit classification splitting in those cases?
- Instead of requiring funds to note the circumstance that led them to split classification of a position on new Item C.7.b as proposed, should we instead require them to note the circumstance in the explanatory notes section of the Form? Should we not require them to note the circumstance leading to the splitting at all? Why or why not?
- Should we allow a fund using the proportionality approach to not classify the liquidity of a holding based on an assumed liquidation of the whole position, but instead classify it by evaluating different portions of the sizes it reasonably anticipates trading and bucketing the entire position accordingly?⁶¹ Would this result in misleading or incorrect liquidity classifications?

⁶¹ For example, under this alternate approach, a fund with a \$100 million position in a security with a reasonably anticipated trading size of \$10 million might determine that it could convert \$4 million to cash in 1-3 days and \$6 million in 4-7 days. The fund might then bucket \$40 million as highly liquid and \$60 million as moderately liquid, even though the fund has previously determined that it could only convert \$4 million into cash in 1-3 days. We believe this approach would potentially result in inaccurate classifications that may not fully reflect the liquidity of a fund's investments, but has been suggested to our staff as a potential method of splitting classifications in some circumstances.

2. *Proposed Disclosure of Cash and Cash Equivalents*

We are also proposing to add to Form N-PORT an additional disclosure relating to a registrant's holdings of cash and cash equivalents not reported in Parts C and D of the Form.⁶² This disclosure would be made publicly available each quarter.⁶³ Form N-PORT currently does not require registrants to specifically report the amount of cash and cash equivalents held by the registrant. For example, as we noted in the Reporting Modernization Adopting Release, we designed Part C of Form N-PORT to require registrants to report certain information on an investment-by-investment basis about each investment held by the registrant.⁶⁴ However, cash and certain cash equivalents are not considered an investment on Form N-PORT, and therefore registrants are not required to report them in Part C of the Form as an investment. Similarly, Part B.1 of Form N-PORT (assets and liabilities) will require information about a registrant's assets and liabilities, but does not require specific disclosure of a registrant's holdings of cash and cash equivalents.⁶⁵

Cash held by a fund is a highly liquid investment under rule 22e-4 and would have been included in the aggregate liquidity profile that we are proposing to eliminate. Without the aggregate liquidity profile, we may not be able to effectively monitor whether a fund is compliant with its HLIM unless we know the amount of cash held by the fund. The additional disclosure of cash and certain cash equivalents by funds will also provide more complete

⁶² See *supra* footnote 15 (noting that the term "registrant" refers to entities required to file Form N-PORT, including all registered management investment companies, other than money market funds and small business investment companies, and all ETFs (regardless of whether they operate as UITs or management investment companies)).

⁶³ See proposed Item B.2.f. of Form N-PORT.

⁶⁴ See Reporting Modernization Adopting Release, *supra* footnote 2.

⁶⁵ We understand that, in addition to cash, a registrant's disclosure of total assets on Part B.1.a. could also include certain non-cash assets that are not investments of the registrant, such as receivables for portfolio investments sold, interest receivable on portfolio investments, and receivables for shares of the registrant.

information that will be useful in analyzing a fund’s HLIM, as well as trends regarding the amount of cash being held, which also correlates to other activities the fund is experiencing, including net inflows and outflows.

As a result, we are proposing to amend Item B.2. of Form N-PORT (certain assets and liabilities) to include a new Item B.2.f. which would require registrants to report “cash and cash equivalents not reported in Parts C and D.” Current U.S. Generally Accepted Accounting Principles (“GAAP”) define cash equivalents as “short-term, highly liquid investments that . . . are . . . [r]eadily convertible to known amounts of cash . . . [and that are] [s]o near their maturity that they present insignificant risk of changes in value because of changes in interest rates.”⁶⁶ However, we understand that certain categories of investments currently reported on Part C of Form N-PORT (schedule of portfolio investments) could be reasonably considered by some registrants as cash equivalents. For example, Item C.4. of Form N-PORT will require registrants to identify asset type, including “short-term investment vehicle (*e.g.*, money market fund, liquidity pool, or other cash management vehicle),” which could reasonably be categorized by some registrants as a cash equivalent. Therefore, in order to ensure the amount reported under proposed Item B.2.f is accurate and does not double count items that are more appropriately reported in Parts C (Schedule of portfolio investments) and D (Miscellaneous securities) of Form N-PORT, we are proposing to require registrants to only include the cash and cash equivalents not reported in those sections.⁶⁷

⁶⁶ See FASB Accounting Standards Codification Master Glossary.

⁶⁷ We also are proposing other amendments to Form N-PORT. In particular, we are proposing to amend General Instruction F (Public Availability) to remove the phrase “of this form” from parenthetical references to Item B.7 and Part D for consistency with other parenthetical cross references in the Form. We also are proposing to amend Part F (Exhibits) to fix a typographical error in the citation to Regulation S-X. In addition, for consistency with the amendments we are proposing today and we are proposing to add Item B.8 (Derivative Transactions) to General Instruction F.

We seek comment on our proposal to require registrants to report cash and cash equivalents on Form N-PORT.

- Should we require registrants to report cash and cash equivalents? Should we require a different formulation for cash? For example, should we require registrants to report separately pledged or segregated cash?
- Should we require registrants to provide more detailed information on cash, rather than reporting cash and cash equivalents together? For example, should we require registrants to report cash separately from cash equivalents in Part C of Form N-PORT? If so, should we require cash to be reported separately for different currencies?

C. Compliance Dates

If the amendments we propose to Forms N-PORT and N-1A related to liquidity risk disclosure are adopted, we would expect to provide for a tiered set of compliance dates based on asset size.⁶⁸ Specifically, we are proposing to align the compliance date for our proposed amendments to Forms N-PORT and N-1A with the revised compliance date we previously adopted for Form N-PORT.⁶⁹ We believe that aligning the compliance date for all liquidity-

⁶⁸ “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* Liquidity Adopting Release, *supra* footnote 2, 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, and we believe the same rationale applies to the changes we are proposing today. *See* Liquidity Adopting Release, *supra* footnote 2, at nn.999 and 1008 and accompanying text.

⁶⁹ *See* Investment Company Reporting Modernization, Investment Company Act Release No. 32936 (Dec. 8, 2017) [82 FR 58731 (Dec. 14, 2017)]. These compliance dates would apply to all Form N-PORT filings after the relevant date and to funds subject to these proposed requirements that file initial registration statements on Form N-1A, or that file post-effective amendments that are annual updates to effective registration statements on Form N-1A, after these proposed compliance dates.

related reporting requirements will allow funds to holistically implement all liquidity reporting and disclosure requirements at the same time and may make the requirements less burdensome.

We request comment on the compliance dates discussed above.

- Should we align the compliance dates for the amendments with the general compliance date for Form N-PORT? Alternatively, should we align the compliance date for the proposed amendments with the compliance date for the other liquidity-related requirements of rule 22e-4 and Form N-PORT?
- Should we provide a longer compliance period for these proposed changes? For example, should we provide an additional six months or one year beyond the compliance dates for the liquidity-related requirements of rule 22e-4 and Form N-PORT? Should we provide a different compliance period for the Form N-PORT changes and the Form N-1A changes? If so, why and how long?

III. ECONOMIC ANALYSIS

A. Introduction

The Commission is sensitive to the potential economic effects of the proposed amendments to Form N-PORT and Form N-1A. 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 proposed amendments as well as any impact 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, and any expected changes to liquidity risk

management practices, including any systems and processes that funds have already implemented in order to comply with the liquidity rule and related requirements as adopted. The baseline also includes the economic effects anticipated in the Liquidity Adopting Release and the Liquidity Extension Release.⁷⁰

The economic baseline's regulatory framework consists of the liquidity rule's requirements adopted by the Commission on October 13, 2016. Under the baseline, larger entities must comply with some of the liquidity rule's requirements, such as the establishment of a liquidity risk management program, by December 1, 2018 and must comply with other requirements, such as the classification of portfolio holdings, by June 1, 2019.⁷¹ Similarly, smaller entities must comply with some of the liquidity rule's requirements by June 1, 2019 and other requirements by December 1, 2019.

The primary SEC-regulated entities affected by these proposed amendments would be mutual funds and ETFs. As of the end of 2016, there were 9,090 mutual funds managing assets of approximately \$16 trillion,⁷² and there were 1,716 ETFs managing assets of approximately \$2.5 trillion.⁷³ Other potentially affected parties include investors, investment advisers that advise funds, issuers of the securities in which these funds invest, and other market participants that could be affected by fund and investor behavior.

⁷⁰ See *supra* footnotes 2 and 8.

⁷¹ See *supra* footnote 68 for a detailed description of large and small entities. The compliance date for some of the requirements related to portfolio holding classification is being delayed. See the Liquidity Extension Release, *supra* footnote 8, for a more detailed discussion of the requirements that are being delayed.

⁷² See 2017 ICI Fact Book, available at https://www.ici.org/pdf/2017_factbook.pdf, at 22, 170, 174. The number of mutual funds includes funds that primarily invest in other mutual funds but excludes 421 money-market funds.

⁷³ See 2017 ICI Fact Book, available at https://www.ici.org/pdf/2017_factbook.pdf, at 180, 181.

C. Economic Impacts

We are mindful of the costs and benefits of the proposed amendments to Form N-PORT and Form N-1A. The Commission, where possible, has sought to quantify the benefits and costs, and effects on efficiency, competition and capital formation expected to result from these amendments. However, as discussed below, the Commission is unable to quantify certain of the economic effects because it lacks information necessary to provide reasonable estimates. The economic effects of the amendments fall into two categories: (1) effects stemming from changes to public disclosure on Form N-PORT and Form N-1A; (2) effects stemming from changes to non-public disclosure on Form N-PORT.

Changes to Public Disclosure

The proposed amendments to Form N-PORT and Form N-1A alter the public disclosure of information about fund liquidity in three ways. First, the proposed amendments rescind the requirement that funds publicly disclose their aggregate liquidity profile on a quarterly basis with a 60-day delay in structured format on Form N-PORT.⁷⁴ Second, the proposed amendments require a fund to provide a narrative description of the fund's liquidity risk management program's operation and effectiveness in unstructured format on Form N-1A. Finally, the proposed amendments require funds and other registrants to report to the Commission on a non-public basis the amount of cash and cash equivalents in their portfolio on Form N-PORT on a monthly basis and to publicly disclose this amount on a quarterly basis with a 60-day delay through EDGAR.⁷⁵

⁷⁴ See *supra* footnote 1 for a definition of "funds." The requirement to publicly disclose aggregate liquidity profiles does not apply to funds that are In-Kind ETFs under the baseline, so it is only being proposed to be rescinded for funds that are not In-Kind ETFs. In-Kind ETFs are included as funds that would provide a narrative description of their liquidity risk management program on Form N-1A under this proposal.

⁷⁵ The Commission will continue to receive non-public position level liquidity information on Form N-PORT.

Funds and other registrants would experience benefits and costs associated with proposed changes to public disclosures on Form N-PORT. Funds⁷⁶ would no longer incur the one-time and ongoing costs associated with preparing the portion of Form N-PORT associated with the aggregate liquidity profile, which would likely constitute a small portion of the aggregate one-time costs of \$158 million and the ongoing costs of \$3.9 million for Form N-PORT that we estimated in the Liquidity Adopting Release.⁷⁷ At the same time, funds and other registrants would also incur additional costs, relative to the baseline, associated with the requirement that they report their holdings of cash and cash equivalents on Form N-PORT.⁷⁸ Because funds and other registrants are already preparing Form N-PORT, and already need to keep track of their cash and cash equivalents for valuation purposes, we expect that these additional costs will not be significant. In aggregate, we expect any additional costs associated with the requirement that funds and other registrants disclose their holdings of cash and cash equivalents to be offset by the savings associated with funds no longer having to report an aggregate liquidity profile. Therefore, we expect that funds and other registrants will not experience a significant net economic effect associated with the direct costs of filing Form N-PORT.⁷⁹ Additionally, to the extent that any risk of herding or correlated trading would exist if funds executed trades in order

See supra footnote 32.

⁷⁶ *See supra* footnote 73.

⁷⁷ *See* Liquidity Adopting Release, *supra* footnote 2, at nn.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.

⁷⁸ *See supra* footnote 15.

⁷⁹ *See* text following *infra* footnote 98.

to make their aggregate liquidity profiles appear more liquid to investors, rescinding the requirement that funds publicly disclose an aggregate liquidity profile would mitigate such risk.⁸⁰

Relative to the baseline, funds would incur costs associated with preparing an annual narrative discussion of their liquidity risk management programs on Form N-1A. We estimate that funds would incur aggregate one-time costs of approximately \$18 million and aggregate ongoing costs of approximately \$8.9 million in association with preparing this narrative discussion.⁸¹

Investors also would experience costs and benefits as a result of the proposed amendments to the public disclosure requirements on Form N-PORT and Form N-1A. To the extent that aggregate liquidity profiles on Form N-PORT would help certain investors make more informed investment choices that match their liquidity risk preferences, rescinding the aggregate liquidity profile requirement will reduce an investor's ability to make more informed investment choices. However, to the extent that aggregate liquidity profiles are not comparable across funds because portfolio holding classifications incorporate subjective factors that may be interpreted differently by different funds, rescinding the aggregate liquidity profile requirement may not reduce these investors' ability to make informed investment choices. Rather, the amendments may reduce the likelihood that investors make investment choices based on any confusion about how the fund's liquidity risk profile should be interpreted.⁸² Additionally, the

⁸⁰ See *supra* footnote 35 and surrounding discussion.

⁸¹ See *infra* footnotes 102 and 105. We estimate funds will incur an additional aggregate one-time of burden of 53,990 hours and an additional aggregate annual burden of 26,995 hours. Assuming a blended hourly rate of \$329 for a compliance attorney (\$345) and a senior officer (\$313), that translate to an additional aggregate one-time burden of $\$17,7627,710 = 53,990 \times \329 and an additional aggregate annual burden of $\$8,881,355 = 26,995 \times \329 .

⁸² Even if aggregate liquidity profiles are not comparable across funds, they may be comparable across time for a given fund, which might provide useful information to investors. This would be the case if a fund maintains a consistent position classification process over time.

annual narrative discussion in Form N-1A may mitigate any reduction in their ability to make more informed investment choices, though this disclosure would be less frequent than the quarterly public disclosure of aggregate liquidity profiles as adopted and would provide information about a fund's liquidity risk management rather than the fund's aggregate liquidity profile of investments.

If certain investors prefer to base their investment decisions on information that is delivered to them directly, those investors would be more likely to use the narrative discussion of a fund's liquidity risk management program on Form N-1A than to have used the aggregate liquidity profile on Form N-PORT to inform their investment decisions. However, if certain other investors could more easily access, reuse, and compare the information about a fund's liquidity risk if included within a structured format on Form N-PORT, those investors would have a reduced ability to make as timely and accurate an analysis when that information is provided to them in the unstructured format of an annual report. To the extent that certain investors rely on third parties to provide them with information for analysis, there may be an increased burden on these third-party providers to search, aggregate and analyze the unstructured information in funds' annual reports. Finally, the proposed amendment to Form N-PORT that requires funds and other registrants to publicly disclose their holdings of cash and cash equivalents on a quarterly basis with a 60-day delay gives investors some potentially useful information about the most liquid assets that a fund previously had available to, for example, meet its redemption obligations.

Changes to Non-Public Disclosure

In addition to the proposed amendments to public disclosures of liquidity information discussed above, the proposed amendments to Form N-PORT give funds the option to split a

given holding into portions that may have different liquidity classifications on their non-public reports on Form N-PORT. Funds may benefit from the proposed amendment because it gives them the option to either include an entire holding within a classification bucket or to allocate portions of the holding across classification buckets. This could benefit a fund if a more granular approach to classification that assigns portions of a portfolio holding to separate classification buckets is more consistent with the fund's preferred approach to liquidity risk management, and reduces the need for funds to develop systems and processes to allocate each holding to exactly one classification bucket.⁸³ In addition, to the extent that providing the option to choose the position classification method most suitable to a given fund results in disclosures on Form N-PORT that more accurately reflect the fund's liquidity profile, the proposed amendments may improve the Commission's ability to monitor liquidity risks in markets and protect investors from liquidity-related developments. However, we acknowledge that providing funds with this option does add an additional subjective decision to the portfolio holding classification process. Thus the proposed amendments could result in classification profiles that are less comparable across funds relative to the baseline.⁸⁴

Efficiency, Competition, and Capital Formation

The proposed amendments have several potential impacts on efficiency, competition, and capital formation. First, if publicly disclosed aggregate liquidity profiles created an incentive for

⁸³ For example, funds that use multiple sub-advisers to manage different sleeves of a portfolio might have to establish more complex systems and processes for combining the classifications of individual sub-advisers into a single classification for the portfolio's aggregate holding of a given security under the rule as adopted. The ability to split a portfolio holding across multiple classification buckets provides funds with a straightforward way of combining the classifications of different sub-advisers.

⁸⁴ Portfolio classifications on Form N-PORT will include CUSIPs or other identifiers that allow Commission staff to identify when different funds classify the same investment using different classification methods. However, comparing such classifications will require some method of adjustment between classifications based on, for example, reasonably anticipated trade size and those based on splitting a position into proportions that are assigned to different classification buckets.

a fund to classify its holdings in a manner that led to a relatively more liquid aggregate liquidity profile in order to attract investors, the proposed amendments remove any such incentive and potentially reduce the likelihood that funds compete based on their aggregate liquidity profiles. To the extent that a fund or other registrant's cash and cash equivalent holdings are interpreted by investors as being associated with lower liquidity risk, funds and other registrants may still have some incentive to compete based on their holdings of cash and cash equivalents under the proposed amendments.⁸⁵ We do not expect the proposed amendments to Form N-1A to have a significant competitive effect.

Second, to the extent that publicly disclosed aggregate liquidity profiles would have helped investors more accurately evaluate fund liquidity risk and make more informed investment decisions, the proposed amendments could reduce allocative efficiency. However, to the extent that aggregate liquidity profiles on Form N-PORT would have increased the likelihood of investors making investment choices based on any confusion about a fund's liquidity risk profile, which would have harmed the efficient allocation of capital, the proposed amendments could increase allocative efficiency. The proposed annual discussion of a fund's liquidity risk management program on Form N-1A and the proposed requirement that funds and other registrants publicly disclose their holdings of cash and cash equivalents on Form N-PORT potentially mitigate this reduction in allocative efficiency, but only to the extent that these proposed requirements provide information that helps investors evaluate fund liquidity risk.

Finally, to the extent that the information provided by aggregate liquidity profiles would have promoted increased investment in certain funds, and the assets those funds invest in,

⁸⁵ However, because cash and cash equivalent holdings do not generate significant returns relative to other holdings, funds and other registrants may have an incentive to shift to non-cash or cash equivalent holdings that generate higher returns.

rescinding the aggregate liquidity profile requirement could reduce capital formation. At the same time, we note that the new public disclosure requirements we are proposing could offset any reduction in capital formation.

In summary, we note that all of the impacts described above are conditioned upon the usefulness to investors of information that we propose to no longer require relative to the usefulness of additional proposed disclosures. We cannot estimate the aggregate effect on efficiency, competition, or capital formation that will result from the new amendments because we do not know the extent to which aggregate liquidity risk profiles, narrative discussion of a fund's liquidity risk management program, or the amount of cash and cash equivalents held by a fund and other registrants are useful to investors in making more informed investment choices.

D. Reasonable Alternatives

The Commission considered several alternatives to the proposed amendments to funds public and non-public disclosure requirements. First, in order to address any potential issues with the interpretation of a fund's aggregate liquidity profile by investors, we could have maintained the public disclosure of this profile on Form N-PORT and added a requirement that funds publicly disclose on Form N-PORT additional information providing context and clarification regarding how their aggregate liquidity profile were generated and should be interpreted. This alternative would have provided investors with some of the benefits of the additional context provided by the proposed narrative discussion on Form N-1A, and, to the extent that it increased investors' understanding of a fund's aggregate liquidity profile, could allow them to make more informed investment choices relative to the baseline. However, to the extent that some investors believe that they can more easily obtain information in a fund's annual report compared to information in the fund's N-PORT filings because annual reports are delivered directly to them, and the investors are not as interested in being able to access, reuse,

and compare the information if included in a structured format on Form N-PORT, this alternative would require investors to seek out this additional information on EDGAR instead of having it delivered directly to them in an annual report. Similarly, we could have required funds to disclose an aggregate liquidity profile in their annual report along with additional information providing context and clarification regarding how its aggregate liquidity profile was generated and should be interpreted. If such disclosure increased investors' understanding of a fund's aggregate liquidity profile, this would allow them to make more informed investment choices relative to the baseline, though they would receive this information at an annual rather than quarterly frequency.

Second, instead of requiring a fund to briefly discuss the operation and effectiveness of its liquidity risk management program in the MDFP section of its annual report, we could have required a more specific discussion of the fund's exposure to liquidity risk over the preceding year, how the fund managed that risk, and how the fund's returns were affected over the preceding year. This alternative could have provided investors with a more in-depth understanding of both a fund's liquidity risk and the fund's approach to managing that risk, which might allow them to make more informed investment decisions compared to the proposed discussion of the fund's liquidity risk management program. However, we preliminarily believe that this alternative would be more costly for funds to implement than the proposed narrative discussion on Form N-1A because it might require funds to perform a more detailed analysis of their liquidity risk over the past year.

Third, we could have amended both Form N-PORT and rule 22e-4 to prescribe an objective approach to classification in which the Commission would specify more precise criteria and guidance regarding how funds should classify different categories of investments. Such an

approach could permit consistent comparisons of different funds' aggregate liquidity profiles, allowing investors to make more informed investment decisions without requiring funds to provide additional contextual discussion of their liquidity risk management programs. However, as discussed in the Liquidity Adopting Release, the Commission may not be able to respond as quickly as market participants to dynamic market conditions that might necessitate changes to such criteria and guidance, and would be unable to account for determinants of investment liquidity that rule 22e-4 treats as fund-specific.⁸⁶

Finally, we could have required that if funds chose to split the classification of any of their portfolio holdings across liquidity buckets when reporting them on the non-public portion of Form N-PORT, they do so for all of their portfolio holdings. This would have ensured that all of the portfolio holdings within a given fund could be interpreted more consistently for any monitoring purposes by the Commission. However, to the extent that being able to choose the classification approach appropriate to each portfolio holding more accurately reflects a manager's judgment of that portfolio holding's liquidity, any reduction in the consistency of portfolio classifications under the proposed amendment could be offset by a more accurate assessment of fund liquidity risk.

E. Request for Comment

We request comment on our analysis of the likely economic effects of the proposed form amendments. We also request comment on the following:

- To what extent will investors rely on the annual narrative discussion of a fund's liquidity risk management program's effectiveness in making investment decisions?

⁸⁶ See Liquidity Adopting Release, *supra* footnote 2, at n.1143 and accompanying text.

- To what extent will investors rely on the quarterly disclosure of a fund or other registrant’s holdings of cash and cash equivalents in making investment decisions?
- Will investors find the new proposed public disclosures more or less informative than an aggregate liquidity profile in making investment choices? Would investors be better off if both types of disclosures were required?
- How much would it cost a fund to discuss the extent and manner in which the fund took liquidity risk, the way that risk was managed, and the effects of these on the fund’s performance over the past year in the MDFP section of its annual report? Would it be more costly than the proposed narrative discussion of the fund’s liquidity risk management program in its annual report? If so, how much more costly would it be? Are there other benefits of this alternative to funds, investors, and other market participants that we should consider?
- Do investors have a reason to access, reuse, or compare the narrative information? If so, would investors’ ease of access and usability of the information improve if the information were provided in a structured format (*e.g.*, XML, XBRL, Inline XBRL)? If so, which structured format would be most useful and why?
- To the extent that certain investors prefer to have information about a fund’s liquidity risk management delivered to them rather than having to seek out that information on EDGAR, would investors prefer that information on Form N-PORT pertaining to aggregate liquidity risk profiles be delivered to them as a separate disclosure in paper or electronic form?
- Are there any other reasonable alternative with significant economic impacts that we should consider?

IV. PAPERWORK REDUCTION ACT

A. Introduction

The proposed amendments to Form N-PORT and Form N-1A contain “collections of information” within the meaning of the Paperwork Reduction Act of 1995 (“PRA”).⁸⁷

The title for the existing collections of information are: “Rule 30b1-9 and Form N-PORT” (OMB Control No. 3235-0730); and “Form N-1A under the Securities Act of 1933 and under the Investment Company Act of 1940, Registration Statement of Open-End Management Investment Companies” (OMB Control No. 3235-0307). The Commission is submitting these collections of information to the Office of Management and Budget (“OMB”) for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. An agency may not conduct or sponsor,

⁸⁷ 44 U.S.C. 3501 through 3521.

and a person is not required to respond to, a collection of information unless it displays a currently valid control number. The Commission is proposing to amend Form N-PORT and Form N-1A. The proposed amendments are designed to improve the reporting and disclosure of liquidity information by funds. We discuss below the collection of information burdens associated with these amendments.

B. Form N-PORT

As discussed above, on October 13, 2016, the Commission adopted new Form N-PORT, which requires all registered management investment companies, other than money market funds and small business investment companies, and unit investment trusts (“UITs”) that operate as ETFs to report information about their monthly portfolio holdings to the Commission in a structured data format.⁸⁸ On the same day, the Commission adopted amendments to Form N-PORT requiring a fund to publicly report on Form N-PORT the aggregate percentage of its portfolio investments that falls into each of the four liquidity classification categories noted above.⁸⁹ Today, the Commission is proposing amendments to rescind the requirement that funds publicly disclose their aggregate liquidity profile on a quarterly basis with a 60-day delay. The Commission also is proposing to require funds and other registrants to report to the Commission on a non-public basis the amount of cash and cash equivalents in their portfolio on Form N-PORT on a monthly basis and to publicly disclose this amount on a quarterly basis with a 60 day delay.⁹⁰ Finally, the Commission is proposing to allow funds the option of splitting a fund’s

⁸⁸ Reporting Modernization Adopting Release, *supra* footnote 2.

⁸⁹ Item B.8.a of Form N-PORT. Form N-PORT also requires public reporting of the percentage of a fund’s highly liquid investments that it has segregated to cover, or pledged to satisfy margin requirements in connection with, derivatives transactions that are classified as moderately liquid, less liquid, or illiquid investments. Item B.8.b of Form N-PORT.

⁹⁰ See *supra* footnote 15 (noting that the term “registrant” refers to entities required to file Form N-PORT, including all registered management investment companies, other than money market funds and small

holding into more than one liquidity classification category in certain specified circumstances.⁹¹ As of the end of 2016, there were 9,090 mutual funds managing assets of approximately \$16 trillion, and there were 1,716 ETFs managing assets of approximately \$2.5 trillion.⁹² Preparing a report on Form N-PORT is mandatory and is a collection of information under the PRA, and the information required by Form N-PORT will be data-tagged in XML format. Except for certain reporting items specified in the form,⁹³ responses to the reporting requirements will be kept confidential for reports filed with respect to the first two months of each quarter; the third month of the quarter will not be kept confidential, but made public sixty days after the quarter end.

In the Liquidity Adopting Release, we estimate that, for the 35% of funds that would file reports on Form N-PORT in house, the per fund average aggregate annual hour burden will be 144 hours per fund, and the average cost to license a third-party software solution will be \$4,805 per fund per year.⁹⁴ For the remaining 65% of funds that would retain the services of a third party to prepare and file reports on Form N-PORT on the fund's behalf, we estimate that the average aggregate annual hour burden will be 125 hours per fund, and each fund will pay an average fee of \$11,440 per fund per year for the services of third-party service provider. In sum, we estimate that filing liquidity-related information on Form N-PORT will impose an average

business investment companies, and all ETFs (regardless of whether they operate as UITs or management investment companies).

⁹¹ See Proposed Item C.7.b of Form N-PORT and Instructions.

⁹² See *supra* footnote 73 and accompanying text.

⁹³ These items include information reported with respect to a fund's Highly Liquid Investment Minimum (Item B.7), derivatives transactions (Item B.8), country of risk and economic exposure (Item C.5.b), delta (Items C.9.f.v, C.11.c.vii, or C.11.g.iv), liquidity classification for portfolio investments (Item C.7), or miscellaneous securities (Part D), or explanatory notes related to any of those topics (Part E) that is identifiable to any particular fund or adviser. See Proposed General Instruction F of Form N-PORT.

⁹⁴ See Liquidity Adopting Release, *supra* footnote 2, at n.1237 and accompanying text.

total annual hour burden of 144 hours on applicable funds, and all applicable funds will incur on average, in the aggregate, external annual costs of \$103,787,680, or \$9,118 per fund.⁹⁵

Today, we are proposing amendments to Form N-PORT to rescind the requirement that a fund report the aggregate percentage of the fund's portfolio representing each of the four liquidity categories. As discussed above, we are rescinding this requirement because we believe that Form N-PORT may not be the most accessible and useful way to convey to the public information about a fund's liquidity risks and the fund's approach to liquidity risk management. Because there would no longer be public disclosure of a fund's aggregate liquidity classification information, we would also re-designate reporting about the amount of a fund's highly liquid investments that are segregated or pledged to cover less liquid derivatives transactions to the non-public portion of the form. We believe that public disclosure of this information would be of limited to no utility to investors without broader context and, therefore, may be confusing. However, because we would otherwise be unable to determine the amount of a fund's highly liquid investments that is actually unavailable to meet redemptions, we believe that funds should continue to report this item to us, on a non-public basis. Finally, we are proposing other amendments to Form N-PORT to add an additional disclosure requirement relating to the fund's and other registrant's holdings of cash and cash equivalents not reported in Parts C and D of the Form⁹⁶ and to allow funds the option of splitting a fund's holding into more than one classification category in three specified circumstances.⁹⁷ We believe these additional

⁹⁵ See Liquidity Adopting Release, *supra* footnote 2, at n.1238 and accompanying text.

⁹⁶ See proposed Item B.2.f. of Form N-PORT.

⁹⁷ See proposed Instructions to Form N-PORT Item C.7.

amendments enhance, the liquidity data reported to the Commission.⁹⁸ In addition, for some funds, these proposed changes may also reduce cost burdens as they comply with the rule.

Based on Commission staff experience, we believe that our proposal to rescind the requirement that funds publicly report the aggregate classification information on Form N-PORT will reduce the estimated burden hours and costs associated with Form N-PORT by approximately one hour. We believe, however, that this reduction in cost will be offset by the increase in cost associated with the other proposed amendments to Form N-PORT, which we also estimate to be one hour. Therefore, we believe that there will be no substantive modification to the existing collection of information for Form N-PORT. As a result, the Commission believes that the current PRA burden estimates for the existing collection of information requirements remain appropriate.

C. Form N-1A

Form N-1A is the registration form used by open-end investment companies. The respondents to the amendments to Form N-1A adopted today are open-end management investment companies registered or registering with the Commission. Compliance with the disclosure requirements of Form N-1A is mandatory, and the responses to the disclosure requirements are not confidential. In our most recent Paperwork Reduction Act submission for Form N-1A, we estimated for Form N-1A a total hour burden of 1,602,751 hours, and the total annual external cost burden is \$131,139,208.⁹⁹

The Commission is proposing to amend Form N-1A to require funds to discuss certain aspects of their liquidity risk management program as part of their annual reports to

⁹⁸ See Liquidity Adopting Release, *supra* footnote 2, at n.293 and accompanying text (discussing the Commission's need for the information reported on Form N-PORT).

⁹⁹ This estimate is based on the last time the rule's information collection was submitted for PRA renewal in 2018.

shareholders. Specifically we are proposing to require a fund to discuss briefly the operation and effectiveness of the fund's liquidity risk management program in the fund's annual report to shareholders, as part of its MDFP.¹⁰⁰ We believe that this proposed amendment will provide effective disclosure that better informs investors of how the fund's liquidity risk and liquidity risk management practices affect their investment than the Form N-PORT public liquidity risk profile.

Form N-1A generally imposes two types of reporting burdens on investment companies: (i) the burden of preparing and filing the initial registration statement; and (ii) the burden of preparing and filing post-effective amendments to a previously effective registration statement (including post-effective amendments filed pursuant to rule 485(a) or 485(b) under the Securities Act, as applicable). We estimate that each fund would incur a one-time burden of an additional five hours,¹⁰¹ to draft and finalize the required disclosure and amend its registration statement. In aggregate, we estimate that funds would incur a one-time burden of an additional 53,990 hours,¹⁰² to comply with the proposed Form N-1A disclosure requirements. Amortizing the one-time burden over a three-year period results in an average annual burden of an additional 17,996.7 hours.¹⁰³

¹⁰⁰ Proposed Item 27(b)(7)(iii) of Form N-1A.

¹⁰¹ This estimate is based on the following calculation: 5 hours (3 hours for the compliance attorney to consult with the liquidity risk management program administrator and other investment personnel in order to produce an initial draft of the MDFP disclosure + 2 hours for senior officers to familiarize themselves with the new disclosure and certify the annual report). These calculations stem from the Commission's understanding of the time it takes to draft and review MDFP disclosure and to update a fund's registration statement.

¹⁰² This estimate is based on the following calculations: 5 hours x 10,798 open-end funds (excluding money market funds and ETFs organized as UITs, and including ETFs that are management investment companies) = 53,990 hours.

¹⁰³ This estimate is based on the following calculation: 53,990 hours ÷ 3 = 17,996.7 average annual burden hours.

Based on Commission staff expertise and experience in reviewing registration statements, we estimate that each fund would incur an ongoing burden of an additional 2.5 hours each year to review and update the required disclosure and amend its registration statement.¹⁰⁴ In aggregate, we estimate that funds would incur an annual burden of an additional 26,995 hours,¹⁰⁵ to comply with the proposed Form N-1A disclosure requirements.

Amortizing these one-time and ongoing hour and cost burdens over three years results in an average annual increased burden of approximately 3.3 hours per fund.¹⁰⁶

In total, we estimate that funds would incur an average annual increased burden of approximately 44,991.7 hours,¹⁰⁷ to comply with the proposed Form N-1A disclosure requirements.

D. Request for Comments

We request comment on whether our estimates for burden hours and any external costs as described above are reasonable. Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission solicits comments in order to: (i) evaluate whether the proposed collections of information are necessary for the proper performance of the functions of the Commission, including whether the information will have practical utility; (ii) evaluate the accuracy of the Commission's estimate of the burden of the proposed collections of information; (iii) determine whether there are ways to

¹⁰⁴ This estimate is based on the following calculation: 2.5 hours (2 hours for the compliance attorney to consult with the liquidity risk management program administrator and other investment personnel in order to produce an initial draft of the MDFP disclosure + .5 hours for senior officers to certify the annual report). These calculations stem from the Commission staff's understanding of the time it takes to review MDFP disclosure and to update a fund's registration statement.

¹⁰⁵ This estimate is based on the following calculation: 2.5 hours x 10,798 open-end funds (excluding money market funds and ETFs organized as UITs, and including ETFs that are management investment companies)= 26,995 hours.

¹⁰⁶ This estimate is based on the following calculation: 5 burden hours (year 1) + 2.5 burden hours (year 2) + 2.5 burden hours (year 3) ÷ 3 = 3.3

¹⁰⁷ This estimate is based on the following calculation: 17,996.7 hours + 26,995 hours =44,991.7 hours.

enhance the quality, utility, and clarity of the information to be collected; and (iv) determine whether there are ways to minimize the burden of the collections of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

The agency is submitting the proposed collections of information to OMB for approval. Persons wishing to submit comments on the collection of information requirements of the proposed amendments should direct them to the Office of Management and Budget, Attention Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should send a copy to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549 1090, with reference to File No. S7-04-18. OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication of this release; therefore, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days after publication of this release. Requests for materials submitted to OMB by the Commission with regard to these collections of information should be in writing, refer to File No. S7-04-18, and be submitted to the Securities and Exchange Commission, Office of FOIA Services, 100 F Street, NE., Washington, DC 20549-2736.

V. INITIAL REGULATORY FLEXIBILITY ANALYSIS

The Commission has prepared the following Initial Regulatory Flexibility Analysis in accordance with section 3(a) of the Regulatory Flexibility Act (“RFA”).¹⁰⁸ It relates to proposed amendments to Form N-PORT and proposed amendments to Form N-1A.

¹⁰⁸ 5 U.S.C. 603(a).

A. Reasons for and Objectives of the Proposed Actions

The Commission adopted rule 22e-4 and related rule and form amendments to enhance the regulatory framework for liquidity risk management of funds.¹⁰⁹ In connection with rule 22e-4, a fund is required to publicly report on Form N-PORT the aggregate percentage of its portfolio investments that falls into each of the liquidity categories enumerated in rule 22e-4. This requirement was designed to enhance public disclosure regarding fund liquidity and redemption practices. However, since we adopted these requirements, we have received letters raising concerns that the public disclosure of a fund's aggregate liquidity classification information on Form N-PORT may not achieve our intended purpose and may confuse and mislead investors. As we discuss further in section II.A above, these letters have led us to believe that the approach of disclosing liquidity information to the public through Form N-PORT may not be the most accessible and useful way to convey fund liquidity information to the public, given that only the Commission, and not the public, would have access to the more granular information and can request information regarding the fund's methodologies and assumptions that would provide needed context to understand this reporting.¹¹⁰

B. Legal Basis

The Commission is proposing amendments to Form N-1A and Form N-PORT under the authority set forth in the Securities Act, particularly section 19 thereof [15 U.S.C. 77a et seq.], the Exchange Act, particularly sections 10, 13, 15, and 23, and 35A thereof [15 U.S.C. 78a et seq.], and the Investment Company Act, particularly, sections 8, 30, and 38 thereof [15 U.S.C. 80a et seq.].

¹⁰⁹ See *supra* section I.

¹¹⁰ See *supra* section 0 at text following footnote 18.

C. Small Entities Subject to the Proposed Liquidity Regulations

An investment company is a small entity if, together with other investment companies in the same group of related investment companies, it has net assets of \$50 million or less as of the end of its most recent fiscal year.¹¹¹ Commission staff estimates that, as of June 31, 2017, there were 64 open-end investment companies (within 60 fund complexes) that would be considered small entities. This number includes open-end ETFs.¹¹²

D. Projected Reporting, Recordkeeping, and Other Compliance Requirements

We are proposing amendments to Form N-1A and Form N-PORT to enhance fund disclosure regarding a fund's liquidity risk management practices. Specifically, the proposed amendments to Form N-PORT¹¹³ would rescind the requirement that funds publicly disclose aggregate liquidity classification information about their portfolios and proposed amendments to Form N-1A would require funds to discuss certain aspects of their liquidity risk management program as part of their annual reports to shareholders.¹¹⁴ In addition, we are proposing amendments to Form N-PORT to allow funds to report multiple classification categories for a single position in certain cases¹¹⁵ and require funds and other registrants to report their holdings of cash and cash equivalents.¹¹⁶

All funds would be subject to the proposed disclosure and reporting requirements, including funds that are small entities. We estimate that 64 funds (comprising 60 fund

¹¹¹ See rule 0-10(a) under the Investment Company Act.

¹¹² This estimate is derived from an analysis of data obtained from Morningstar Direct as well as data reported on Form N-SAR filed with the Commission for the period ending June 30, 2017.

¹¹³ See proposed amendments to Item B.8 of Form N-PORT.

¹¹⁴ See proposed amendments to Item 27(b)(7)(iii) of Form N-1A.

¹¹⁵ See proposed Item C.7.b of Form N-PORT and Instructions.

¹¹⁶ See proposed Item B.2.f. of Form N-PORT.

complexes) are small entities that would be required to comply with the proposed disclosure and reporting requirements. As discussed above, we do not believe that our proposed amendments will change Form N-PORT's estimated burden hours and costs.¹¹⁷ We estimate that each fund would incur a one-time burden of an additional five hours,¹¹⁸ each year to draft and finalize the required Form N-1A disclosure and amend its registration statement. For purposes of this analysis, Commission staff estimates, based on outreach conducted with a variety of funds, that small fund groups will incur approximately the same initial and ongoing costs as large fund groups. Therefore, in the aggregate, we estimate that funds that are small entities would incur a one-time burden of an additional 320 hours,¹¹⁹ to comply with the proposed Form N-1A disclosure requirements. Amortizing the one-time burden over a three-year period results in an average annual burden of an additional 106.7 hours.¹²⁰ We estimate that each fund would incur an ongoing burden of an additional 2.5 hours each year to review and update the required Form N-1A disclosure and amend its registration statement.¹²¹ Therefore, we estimate that funds that

¹¹⁷ See *supra* text accompanying footnote 79.

¹¹⁸ See *supra* footnote 101 (noting that this estimate is based on the Commission staff's understanding of the time it takes it takes to draft and review MDFP disclosure and to update a fund's registration statement, including the time it takes for the compliance attorney to consult with the liquidity risk management program administrator and other investment personnel in order to produce an initial draft of the MDFP disclosure as well as the time it takes for senior officers to familiarize themselves with the new disclosure and certify the annual report).

¹¹⁹ This estimate is based on the following calculations: 5 hours x 64 = 320 hours.

¹²⁰ This estimate is based on the following calculation: 320 hours ÷ 3 = 106.7 average annual burden hours.

¹²¹ See *supra* footnote 104 and accompanying text (noting that this estimate is based on the Commission staff's understanding of the time it takes it takes to review MDFP disclosure and to update a fund's registration statement, including the time it takes for the compliance attorney to consult with the liquidity risk management program administrator and other investment personnel in order to produce an initial draft of the MDFP disclosure as well as the time it takes for senior officers to certify the annual report).

are small entities will incur an ongoing burden of an additional 160 hours to comply with the proposed Form N-1A disclosure requirements.¹²²

Amortizing these one-time and ongoing hour and cost burdens over three years results in an average annual increased burden of approximately 4.2 hours per fund.¹²³ In total, we estimate that funds that are small entities would incur an average annual increased burden of approximately 266.7 hours, to comply with the proposed Form N-1A disclosure requirements.

E. Duplicative, Overlapping, or Conflicting Federal Rules

The Commission has not identified any federal rules that duplicate, overlap, or conflict with the proposed liquidity regulations.

F. Significant Alternatives

The RFA directs the Commission to consider significant alternatives that would accomplish our stated objectives, while minimizing any significant economic impact on small entities. We considered the following alternatives for small entities in relation to the proposed liquidity disclosure requirements: (i) exempting funds that are small entities from the proposed disclosure requirements on Form N-1A, or establishing different disclosure or reporting requirements, or different disclosure frequency, to account for resources available to small entities; (ii) clarifying, consolidating, or simplifying the compliance requirements under the amendments for small entities; (iii) using performance rather than design standards; and (iv) exempting funds that are small entities from other proposed amendments to Form N-PORT.

We do not believe that exempting any subset of funds, including funds that are small entities, from the proposed amendments would permit us to achieve our stated objectives. Nor do we believe that clarifying, consolidating or simplifying the proposed amendments for small

¹²² This estimate is based on the following calculations: 2.5 hours x 64 = 160 hours.

¹²³ This estimate is based on the following calculations: (160 hours + 106.7 hours) ÷ 64 funds = 4.2 hours.

entities would satisfy those objectives. In particular, we do not believe that the interest of investors would be served by these alternatives. We believe that all fund investors, including investors in funds that are small entities, would benefit from accessible and useful disclosure about liquidity risk, with appropriate context, so that investors may understand its nature and relevance to their investments.¹²⁴ We also believe that all fund investors would benefit from the other proposed amendments to Form N-PORT that would preserve, and in some cases enhance, the liquidity data reported to the Commission by allowing funds to more accurately reflect their liquidity.¹²⁵ We note that the current disclosure requirements for reports on Forms N-1A and N-PORT do not distinguish between small entities and other funds. Finally, we determined to use performance rather than design standards for all funds, regardless of size, because we believe that providing funds with the flexibility to determine how to design their MDFP disclosures allows them the opportunity to tailor their disclosure to their specific risk profile. By contrast, we determined to use design standards for our proposed amendments to Form N-PORT because we believe information reported to the Commission on the Form must be uniform to the extent practicable in order for the Commission to carry out its oversight and monitoring responsibilities.

G. General Request for Comment

The Commission requests comments regarding this analysis. We request comment on the number of small entities that would be subject to the proposed form amendments and whether the proposed form amendments would have any effects on small entities that have not been discussed. We request that commenters describe the nature of any effects on small entities subject to the proposed form amendments and provide empirical data to support the nature and

¹²⁴ See *supra* text accompanying footnote 96.

¹²⁵ See *supra* section 0 at text accompanying footnote 98.

extent of such effects. We also request comment on the estimated compliance burdens of the proposed form amendments and how they would affect small entities.

VI. CONSIDERATION OF IMPACT ON THE ECONOMY

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996, or “SBREFA,”¹²⁶ we must advise OMB whether a proposed regulation constitutes a “major” rule. Under SBREFA, a rule is considered “major” where, if adopted, it results in or is likely to result in (1) an annual effect on the economy of \$100 million or more; (2) a major increase in costs or prices for consumers or individual industries; or (3) significant adverse effects on competition, investment or innovation.

We request comment on the potential impact of the proposed amendments on the potential effect on the economy on an annual basis; any potential increase in costs or prices for consumers or individual industries; and any potential effect on competition, investment, or innovation.

Commenters are requested to provide empirical data and other factual support for their views to the extent possible.

VII. STATUTORY AUTHORITY

The Commission is proposing amendments to Form N-1A and Form N-PORT under the authority set forth in the Securities Act, particularly section 19 thereof [15 U.S.C. 77a et seq.], the Exchange Act, particularly sections 10, 13, 15, and 23, and 35A thereof [15 U.S.C. 78a et seq.], and the Investment Company Act, particularly, sections 8, 30 and 38 thereof [15 U.S.C. 80a et seq.].

¹²⁶ Public Law 104-121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C., 15 U.S.C. and as a note to 5 U.S.C. 601).

List of Subjects in 17 CFR Part 274

Investment companies, Reporting and recordkeeping requirements, Securities.

Text of Rules and Forms

For the reasons set out in the preamble, title 17, chapter II of the Code of Federal Regulations is amended as follows:

PART 274 - FORMS PRESCRIBED UNDER THE INVESTMENT COMPANY ACT OF 1940

1. The authority citation for part 274 continues to read, in part, as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 78c(b), 78l, 78m, 78n, 78o(d), 80a-8, 80a-24, 80a-26, 80a-29, and Pub. L. 111-203, sec 939A, 124 Stat. 1376 (2010), unless otherwise noted.

* * * * *

2. Amend Form N-1A (referenced in 274.11A) by:

a. In Item 27 adding new paragraph (b)(7)(iii).

The addition reads as follows:

Note: The text of Form N-1A does not, and this amendment will not, appear in the Code of Federal Regulations.

Form N-1A

* * * * *

Item 27. Financial Statements

(a) * * *

(b) * * *

(7) *Management’s Discussion of Fund Performance.*

* * *

(iii) Briefly discuss the operation and effectiveness of the Fund’s liquidity risk management program during the most recently completed fiscal year.

* * * * *

3. Amend Form N-PORT (referenced in § 274.150) by:

- a. In the General Instructions, revising the second paragraph of F. Public Availability;
- b. In Part B, amending Item B.2 by adding Item B.2.f;
- c. In Part B, revising Item B.8;
- d. In Part C, revising Item C.7; and
- e. Revising Part F.

The revisions read as follows:

Note: The text of Form N-PORT does not, and this amendment will not, appear in the Code of Federal Regulations.

FORM N-PORT
MONTHLY PORTFOLIO INVESTMENTS REPORT

* * * * *

F. Public Availability

* * *

The SEC does not intend to make public the information reported on Form N-PORT for the first and second months of each Fund’s fiscal quarter that is identifiable to any particular fund or adviser, or any information reported with respect to a Fund’s Highly Liquid Investment Minimum (Item B.7), Derivatives Transactions (Item B.8), country of risk and economic exposure (Item C.5.b), delta (Items C.9.f.v, C.11.c.vii, or C.11.g.iv), liquidity classification for

portfolio investments (Item C.7), or miscellaneous securities (Part D), or explanatory notes related to any of those topics (Part E) that is identifiable to any particular fund or adviser. However, the SEC may use information reported on this Form in its regulatory programs, including examinations, investigations, and enforcement actions.

* * * * *

Part B: Information About the Fund

* * *

Item B.2.f. Cash and cash equivalents not reported in Parts C and D.

* * *

Item B.8 Derivatives Transactions. For portfolio investments of open-end management investment companies, provide the percentage of the Fund's Highly Liquid Investments that it has segregated to cover or pledged to satisfy margin requirements in connection with derivatives transactions that are classified among the following categories as specified in rule 22e-4 [17 CFR 270.22e-4]:

1. Moderately Liquid Investments
2. Less Liquid Investments
3. Illiquid Investments

* * *

Part C: Schedule of Portfolio Investments

* * *

Item C.7.a Liquidity classification information.

For portfolio investments of open-end management investment companies, provide the liquidity classification(s) for each portfolio investment among the following categories as

specified in rule 22e-4 [17 CFR 270.22e-4]. For portfolio investments with multiple liquidity classifications, indicate the percentage amount attributable to each classification.

- i. Highly Liquid Investments
- ii. Moderately Liquid Investments
- iii. Less Liquid Investments
- iv. Illiquid Investments

Item C.7.b. If attributing multiple classification categories to the holding, indicate which of the three circumstances listed in the Instructions to Item C.7 is applicable.

Instructions to Item C. 7 Funds may choose to indicate the percentage amount of a holding attributable to multiple classification categories only in the following circumstances: (1) if a fund has multiple sub-advisers with differing liquidity views; (2) if portions of the position have differing liquidity features that justify treating the portions separately; or (3) if the fund chooses to classify the position through evaluation of how long it would take to liquidate the entire position (rather than basing it on the sizes it would reasonably anticipated trading). In (1) and (2), a fund would classify using the reasonably anticipated trade size for each portion of the position.

* * *

Part F: Exhibits

For reports filed for the end of the first and third quarters of the Fund's fiscal year, attach no later than 60 days after the end of the reporting period the Fund's complete portfolio holdings as of the close of the period covered by the report. These portfolio holdings must be presented in accordance with the schedules set forth in §§210.12-12 – 210.12-14 of Regulation S-X [17 CFR 210.12-12 – 210.12-14].

* * * * *

By the Commission.

Dated: March 14, 2018

Brent J. Fields
Secretary

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