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SEC PROPOSES MANDATORY SWING PRICING FOR MUTUAL FUNDS AND REVISED LIQUIDITY REQUIREMENTS

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On November 2, 2022, the US Securities and Exchange Commission (SEC), by a 3-2 party line vote, proposed amendments (the Proposal) to the liquidity risk management programs rule (Rule 22e-4) under the Investment Company Act of 1940, as amended (1940 Act); and amendments that would require certain funds to implement "swing pricing" and impose a "hard close" on the acceptance of purchase and redemption orders.[1] The SEC described the Proposal as intended to "better prepare open-end funds for stressed conditions," citing systemic issues associated with the onset of the COVID-19 pandemic, as well as to "mitigate dilution of shareholders' interests" and "enhance how funds manage their liquidity risks."[2]

The proposed swing pricing and "hard close" requirements that would apply to open-end mutual funds[3] other than exchange traded funds (ETFs) and money market funds (Mutual Funds) would fundamentally alter how (and when) fund shares are sold and priced, and may reduce the attractiveness of Mutual Funds compared to other investment products. In addition, the Proposal would have significant implications for funds' portfolio compositions and investment strategies and would also impose substantial new costs and operational complexities for both funds and intermediaries.

Key takeaways:

- The proposed revisions to the Rule 22e-4 liquidity classification framework would eliminate the "less liquid investment" category, moving investments with extended settlement periods, such as bank loans, into the "illiquid investment" category;
- The Proposal would standardize liquidity assessments across all asset classes, replacing the "reasonably anticipated trade size" assumption with a required 10% pro rata vertical slice approach;
- Under the Proposal, funds would be required to classify and potentially reclassify holdings daily, rather than normally on a monthly basis;
- Liquidity classifications would be required to be holdings-specific, rather than based on asset class;
- All funds would be required to implement a highly liquid investment minimum (HLIM) of at least 10% of a fund's net assets, and the Proposal would eliminate the current exemption from implementing an HLIM for primarily highly liquid funds;
- Form N-PORT reporting frequency would change from quarterly to monthly, and aggregate liquidity classifications would be reported publicly;
- Swing pricing, which requires a fund to reduce its net asset value (NAV) to reflect estimated transaction costs associated with net redemptions and net investments (where net investments exceed 2% of the fund's NAV), would be required for all Mutual Funds under the Proposal; and
- The Proposal would require Mutual Funds to have a "hard close," intended to help facilitate the implementation of swing pricing.

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1 Open-End Fund Liquidity Risk Management Programs and Swing Pricing; Form N-PORT, Investment Company Act Release No. 34746 (proposed Nov. 2, 2022).

2 Press Release, US Securities and Exchange Commission, SEC Proposes Enhancements to Open-End Fund Liquidity Framework (Nov. 2, 2022).

A summary of proposed changes in the Proposal is included as Appendix A.

Comments are due on the Proposal 60 days after its publication in the *Federal Register*.

CHANGES TO LIQUIDITY RISK MANAGEMENT PROGRAMS

CHANGES TO THE LIQUIDITY CLASSIFICATION FRAMEWORK

Overview

As currently in force, Rule 22e-4 requires that fund investments be classified into four different liquidity categories (highly liquid, moderately liquid, less liquid, and illiquid) based on the number of days within which it reasonably expects the investment would be convertible to cash, sold, or disposed of, without significantly changing the investment's market value. The Proposal includes several changes to the classification framework indicated in Table 1:

Table 1: Proposed Changes to the Liquidity Classifications (Redline Form)

Liquidity Category	Amended Rule 22e-4
Highly Liquid Investment	Any ~~cash~~ **US dollars** held by a fund and any investment that the fund reasonably expects to be convertible into ~~cash~~ **US dollars** in current market conditions in three business days or less without the conversion to cash significantly changing the market value of the investment.
Moderately Liquid Investment	~~Any investment that the fund reasonably expects to be convertible into cash in current market conditions in more than three calendar days but in seven calendar days or less, without the conversion to cash significantly changing the market value of the investment.~~ **Any investment that is neither a highly liquid investment nor an illiquid investment.**
Less Liquid Investment ***(No longer a category under the Proposal)***	~~Any investment that the fund reasonably expects to be able to sell or dispose of in current market conditions in seven calendar days or less without the sale or disposition significantly changing the market value of the investment, but where the sale or disposition is reasonably expected to settle in more than seven calendar days.~~
Illiquid Investment	Any investment that the fund reasonably expects ~~cannot be sold or disposed of~~ **not to be convertible to US dollars** in current market conditions in seven calendar days or less without the sale or disposition significantly changing the market value of the investment **and any investment whose fair value is measured using an unobservable input that is significant to the overall measurement.**

Elimination of Less Liquid Investment Category

One of the most significant proposed changes to the liquidity classification framework is the elimination of the "Less Liquid Investment" category. Investments currently classified as less liquid would be redesignated as illiquid investments under the Proposal.[4]

This change will have an outsized impact on funds that hold a significant percentage of their assets in bank loans and other investments with extended settlement periods. Under current Rule 22e-4, funds have generally categorized these investments in the Less Liquid Investment category, which is not

[4] Proposal at 63.

subject to any specific regulatory investment limitations. Under the changes described in the Proposal, these assets would be classified as Illiquid Investments.[5] Under Rule 22e-4, funds may not invest more than 15% of their net assets in Illiquid Investments. As a result, the elimination of the Less Liquid Investment category would likely restrict funds' flexibility to invest in asset classes that typically have settlement periods lasting longer than seven days, potentially rendering some investment strategies incompatible with the open-end fund structure and forcing some funds to convert to a closed-end structure, fundamentally change investment strategies, or liquidate.

The SEC acknowledged this potential impact in the Proposal, noting that "advisers with strategies that have 15% or more of assets in investments classified as less liquid and illiquid may change those strategies, close funds, or consider using a closed-end fund or other investment vehicle structure that is not subject to rule 22e-4."[6] That said, the SEC contemplates that this requirement may incentivize bank loan market participants to continue their efforts to shorten the settlement cycle for bank loans, which the SEC acknowledges "would involve costs."[7]

Amendments to References to "Cash"

The Proposal would amend the term "convertible to cash" to "convertible to US dollars" and makes conforming amendments to the definition of "cash" in reference to the ability of a fund to sell or dispose of an investment or to settle a transaction in US dollars. These amendments would codify prior Commission statements that cash means "cash held in US dollars," and would not include, for example, cash equivalents or foreign currency. The SEC noted that this requirement is intended to align with the requirement for funds to make redemption payments in US dollars. In addition, for consistency and clarity, the Proposal seeks to amend other references to "cash" in Rule 22e-4 to refer to US dollars.

Changes to Illiquid Investments: Adding Fair Valued Investments

The Proposal would amend the definition of Illiquid Investment to additionally include investments whose fair value is measured using an unobservable input that is significant to the overall measurement, citing concerns that investments without active, liquid, and visible markets may not be able to be sold in time to meet redemptions. This requirement aligns with the Level 3 category of the fair value hierarchy established under US Generally Accepted Accounting Principles (US GAAP). The SEC acknowledged in the Proposal that observability is a valuation concept that may not always correspond to liquidity. As a result, the SEC acknowledged that to the extent there is a liquid market for investments using unobservable inputs, this proposed amendment would cause funds to overestimate the illiquidity of their portfolios, but the SEC projected this would impact only approximately 0.07% of all open-end fund assets based on information as of December 31, 2021.[8]

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5 If a fund determined that an investment that it currently classified as a Less Liquid Investment could be converted to US dollars within seven calendar days or less (assuming a sale of 10% of the investment), then the fund could classify the investment as a Moderately Liquid Asset.

6 Proposal at 63.

7 Proposal at 63.

8 In the Proposal, the SEC notes that, as of December 2021, mutual funds held $76.3 billion in assets that were considered Level 3 assets under US GAAP, $19 billion of which were considered Highly Liquid or Moderately Liquid Investments. Proposal at 64-65.

NEW REQUIREMENTS FOR LIQUIDITY DETERMINATIONS

Replacement of "Reasonably Anticipated Trade Size"

Rule 22e-4 currently requires a fund to consider the portion of its holdings that might be sold to meet liquidity demand when determining the liquidity category of a given investment. This consideration is tied to a "reasonably anticipated trade size" (RATS), which is a principles-based determination based on an assessment of the fund's investments and distribution profile.

Citing concerns that liquidity determinations based on a RATS do not always capture stressed scenarios, the Proposal would require funds assume that the fund will be liquidating 10% of its net assets and that a "vertical pro rata slice" of a fund's portfolio would be liquidated. This change would prevent funds from assuming that redemptions would likely be satisfied by sales of the fund's more liquid assets (and applying a smaller RATS to the less liquid holdings).

Minimum Value Impact Standards

Currently, when a fund classifies the liquidity of its investments under Rule 22e-4, it must analyze whether a sale or disposition would significantly change the market value of the investment. Current Rule 22e-4 allows for flexibility in this analysis to accommodate different asset classes, investment strategies, shareholder compositions and liquidity methodologies, among other factors. Citing concerns regarding comparability of liquidity classifications across funds, the Proposal would include a specific definition of "significantly changing the market value of an investment" that would vary based on the type of investment and would mean:

- For shares listed on a securities exchange: a transaction of more than 20% of the 20-day average daily trading volume (ADTV); and
- For other investments, such as fixed income securities: a transaction that the fund reasonably expects would result in a decrease in the price of an investment by more than 1%.

The SEC believes that requiring prescriptive elements for this determination will increase consistency and comparability across fund reporting.

Removing Asset Class Determinations

Under current Rule 22e-4, a fund may classify portfolio investments based on asset class, so long as the fund or its adviser, after reasonable inquiry, does not have information about any market, trading, or investment-specific considerations that is reasonably expected to significantly affect the liquidity characteristics of an investment so as to suggest a different classification for that investment. The Proposal would require all liquidity determinations under Rule 22e-4 to be made on an investment-by-investment basis. The SEC notes in the Proposal that asset class determinations are not widely used by funds, and that asset class determinations do not align with certain other elements of the Proposal, such as the value impact standard, which (as discussed above) requires the size of the investment to be specifically considered.

INCREASED FREQUENCY OF REQUIRED LIQUIDITY DETERMINATIONS – DAILY

Rule 22e-4 currently requires that funds review their liquidity classifications at least monthly in connection with reporting on Form N-PORT, and more frequently if changes in relevant market, trading, and investment-specific considerations are reasonably expected to materially affect one or more of a fund's investment classifications. The Proposal would require funds to classify their portfolio investments on a daily basis. The SEC states in the Proposal that it expects daily classification to reflect current market conditions more accurately and would provide funds with more data for analysis to prepare for future stressed conditions. The SEC notes that daily classification would increase costs but may ultimately lead to a more standardized, timely, and efficient overall process.

CHANGES TO HIGHLY LIQUID INVESTMENT MINIMUM REQUIREMENT

Rule 22e-4 currently requires funds (other than in-kind ETFs and funds deemed to be "primarily highly liquid") to determine a highly liquid investment minimum (HLIM), a minimum percentage of the fund's net assets that must be represented by investments classified as highly liquid. Currently, funds are permitted discretion to set an HLIM based on their own facts and circumstances. Under the Proposal, all funds, including those funds deemed to be "primarily highly liquid" (except in-kind ETFs) would be required to set HLIMs of at least 10% of the fund's net assets. The SEC believes that a fixed 10% HLIM for all funds would better prepare funds to meet redemptions in times of stressed markets, acknowledging that some funds may be required to hold higher levels of Highly Liquid Investments than they currently hold. A higher HLIM requirement may, of course, adversely affect the investment performance of some funds.

In addition, the Proposal includes new specific requirements relating to assessing compliance with an HLIM. Specifically, in assessing compliance with a fund's HLIM, the fund would be required to: (1) subtract the value of any highly liquid assets that are posted as margin or collateral in connection with any derivatives transaction that is classified as moderately liquid or illiquid; and (2) subtract any fund liabilities.[9] For these purposes, "liabilities" would include investment liabilities and amounts payable for investment advisory, management, and service fees.[10]

Changes to Illiquid Investments Limitation

Rule 22e-4 currently limits a fund's ability to acquire illiquid investments. Specifically, the rule prohibits a fund from acquiring any investment if, immediately after the acquisition, the fund would have invested more than 15% of its net assets in Illiquid Investments. The Proposal includes somewhat technical amendments that relate to determining whether the fund is in compliance with the limitation on illiquid investments. In testing compliance with this limit, a fund would treat as illiquid the amount of margin or collateral it has posted in connection with a derivatives transaction that is classified as an illiquid investment and that the fund would only receive if it exited the derivatives transaction.

SWING PRICING AND HARD CLOSE REQUIREMENTS

SWING PRICING

The Proposal would also amend Rule 22c-1 to require all Mutual Funds to engage in swing pricing when Mutual Funds experience net redemptions and also when there are net purchases that exceed an identified threshold. Swing pricing is a "process of adjusting a fund's current NAV when certain conditions are met, such that the transaction price effectively passes on costs stemming from shareholder inflows or outflows to the shareholders engaged in that activity."[11] The Proposal describes the SEC's concern that the costs associated with such trading activity are borne by non-transacting shareholders, which in turn may incentivize shareholders, motivated by a first-mover advantage, to redeem quickly to avoid losses. The SEC further notes that these concerns would be amplified further under stressed market conditions.

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9 Proposal at 84.

10 Proposal at 88.

11 Proposal at 93-94.

The SEC argues that swing pricing could reduce any first-mover advantage, mitigate dilution of non-transacting investors, and more fairly allocate costs associated with trading activity.[12]

Swing pricing is currently permitted (but not required) under Rule 22c-1. At present, no US funds have implemented swing pricing, even though they have been permitted to do so for the last five years. According to the SEC, one reason funds have not implemented swing pricing may be the significant operational complications discussed at some length in the Proposal, including lack of timely fund flow information. The SEC also acknowledges that, even if funds had access to sufficient flow information, some funds may not implement swing pricing because of cost concerns and because investors in US funds are unfamiliar with swing pricing. The SEC nevertheless notes in the Proposal that a regulatory requirement that mandates swing pricing "would help overcome the collective action problem that may exist under the current optional framework and may have prevented swing pricing implementation."[13]

Citing academics, market participants and swing pricing practices in Europe, the SEC lays out the case for swing pricing. Specifically, the SEC believes that swing pricing would provide significant benefits to long-term fund investors by reducing dilution attributable to transaction costs associated with shareholder activity.[14]

As proposed, swing pricing permitted under Rule 22c-1 would be required for all Mutual Funds (other than feeder funds in a master feeder structure) and would apply to both net purchases and net redemptions. In a change from the current rule, which allows a fund to devise its own swing pricing thresholds that would trigger the application of swing factors, the Proposal would set prescriptive thresholds. Specifically, swing factors would always apply in the case of net redemptions, but swing factors would only apply in cases of net purchases when the amount of net purchases exceeds 2% of the Mutual Fund's net assets (the "inflow swing threshold").[15]

Where Mutual Funds exceed these thresholds, a Mutual Fund would be required to adjust its NAV by a swing factor representing "good faith estimates, supported by data, of the costs the [Mutual Fund] would incur if it purchased or sold a *pro rata* amount of each investment in its portfolio to satisfy the amount of net purchases or net redemptions (*i.e.*, a vertical slice)."[16] For net redemptions in excess of 1% of a Mutual Fund's net assets and for net purchases in excess of 2% of a Mutual Fund's net assets, the Mutual Fund would also be required to assess whether market impact costs (i.e., the reduction in value associated with large sales of investments) would occur, and if so, incorporate those costs into the swing factor.[17] The Proposal specifies how a Mutual Fund would calculate market impact, including how a Mutual Fund would estimate the appropriate market impact factor (i.e., the percentage change in the value of the investment if it were purchased or sold, per dollar of the amount of the investment that would be purchased or sold).[18] In addition, the Proposal appears to require swing pricing even if a fund does not actually need to sell securities to meet net redemptions—e.g. if the fund held sufficient cash or

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12 Proposal at 94-95.

13 Proposal at 306.

14 In particular, the SEC cited a study that indicated that, during a three-week period of elevated redemptions in March 2020, European funds that implemented swing pricing recouped roughly six basis points of total net assets on average from redeeming investors. Proposal at 96-97.

15 Proposal at 108.

16 Proposal at 116.

17 Proposal at 106-108.

18 Proposal at 120-121.

if the fund had securities that are maturing before the redemption proceeds needed to be paid out.[19] Likewise, for purchases above the inflow swing threshold, it appears that a swing factor adjustment would need to be made even if the fund is not planning to use the proceeds to purchase additional securities—e.g. if the portfolio manager decides to hold cash and take a more defensive posture.

All applicable Mutual Funds would be required to establish and implement board-approved swing pricing policies and procedures. In addition, under the Proposal, the Mutual Fund's board would designate the Mutual Fund's swing pricing administrator (SPA).[20] The SPA must be the Mutual Fund's investment adviser, an officer, or group of officers responsible for administering the Mutual Fund's swing pricing policies and procedures, and the SPA cannot include the Mutual Fund's portfolio manager(s).[21] The SPA would be required to prepare an annual written report to the Mutual Fund's board that describes the SPA's findings with respect to the adequacy and effectiveness of the Mutual Fund's swing pricing policies and procedures.[22]

HARD CLOSE REQUIREMENT

Effective swing pricing requires reliable information regarding fund flows. Under current industry practice, if an investor submits an order to an intermediary to purchase or redeem fund shares, that order will be executed at the current day's price as long as the intermediary receives the order before the pricing time (typically 4:00 pm ET). The fund, however, might not receive information about that order until much later, sometimes as late as the next morning.

To implement the swing pricing requirements, the SEC proposes to amend Rule 22c-1, the rule governing the pricing of mutual fund shares, to require that a Mutual Fund, its transfer agent, or its registered clearing agency (and not other fund intermediaries) receive purchase and redemption orders by an established cut-off time in order to receive a given day's price (a "hard close").[23] The SEC states that the receipt of orders before the time at which the Mutual Fund determines the value of its holdings and calculates its NAV (pricing time) (typically 4:00 pm ET) "would facilitate the receipt of timely flow information to inform swing pricing decisions," and the SEC further believes this would help prevent late trading, modernize and improve order processing, and reduce operational risk.[24] This is a dramatic change in thinking by the SEC, which has generally pushed back against funds that sought to establish a cut-off time, particularly for redemptions, prior to the fund's pricing time.

The SEC notes that the Proposal would require Mutual Funds and intermediaries to make significant changes to their business practices in connection with the proposed hard close requirement and that investors transacting through intermediaries may lose some flexibility in when they may submit orders to receive that day's price, as intermediaries may institute earlier cut-off times.[25] It should be noted that the loss of flexibility could potentially be quite meaningful to investors: For example, under current rules and practices, an investor who invests through an intermediary can place an order at 3:30 pm ET and still receive that day's NAV, even if the order is not immediately transmitted to the fund. With a hard close,

19 The SEC notes that "every net redemption can potentially involve trading or borrowing costs that dilute the value of the fund, as well as depletion of a fund's liquidity for remaining shareholders." Proposal at 106.

20 Proposal at 109.

21 Proposal at 109, 413.

22 Proposal at 18.

23 Proposal at 37, 135.

24 Proposal at 37.

25 Proposal at 144, 146, 149.

however, that investor's transaction may not be effected until a full trading day later. The SEC also acknowledges that certain types of retirement plan transactions (e.g., plan loans, withdrawals, or transfers) could be adversely impacted, and these requirements could result in Mutual Funds no longer being compatible with certain retirement plan platforms. It is therefore possible that, if the Proposal is adopted, collective investment trusts, which are not subject to 1940 Act regulation by the SEC, may take a more prominent role on retirement plan platforms.

Under the Proposal, eligible orders to purchase or redeem a specific number or value of Mutual Fund shares would have to include certain information about the size of an investor's intended trade. The SEC states that a Mutual Fund would then use this information to calculate investor flows, which in turn would facilitate swing pricing.[26]

In addition, the Proposal notes that the new hard close requirements would necessitate revisions to Item 11 of Form N-1A and the relevant disclosure in a Mutual Fund's prospectus. The revised disclosure would inform investors that orders placed with a financial intermediary may need to be submitted earlier than a Mutual Fund's pricing time to receive the next calculated NAV.[27]

As part of its Proposal, the SEC seeks public comment on alternative solutions to imposing a hard close requirement, such as the use of indicative flows, estimated flows, or delayed cut-off times for intermediaries.[28]

REPORTING

N-PORT REPORTING FREQUENCY

The Proposal also includes several amendments to fund reporting requirements. Registered management investment companies and ETFs organized as unit investment trusts are currently required to file reports on a quarterly basis on Form N-PORT about their portfolios and each of their portfolio holdings as of month-end, with information included for the third month of the quarter becoming publicly available 60 days after the filing. Such filings are due 60 days following the quarter end. The Proposal includes amendments that would require reports on Form N-PORT to be filed on a monthly basis within 30 days of month-end, with much of the reported information becoming publicly available 60 days after month-end. The changes are intended to provide shareholders and the SEC with more timely information regarding a fund's portfolio and the portfolio's liquidity profile.

PUBLIC DISCLOSURE OF LIQUIDITY CLASSIFICATIONS

In a significant departure from current requirements, the Proposal would require a fund's N-PORT filing to include information regarding the aggregate percentage of its portfolio represented in each of the three proposed liquidity categories. These aggregate percentages would be publicly reported. When calculating a fund's aggregate liquidity classifications, a fund would be required to reduce its reported amount of highly liquid assets by the amount of highly liquid assets that it posts as margin or collateral for derivatives transactions that are not highly liquid and by the amount of the fund's liabilities. In addition, a fund would also increase its reported amount of illiquid assets by the amount of collateral available upon exit of illiquid derivatives transactions. The proposed requirement is similar to the disclosure requirements that were originally adopted in connection with Rule 22e-4 in 2016, which were later amended to replace

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[26] Proposal at 135-136.

[27] Proposal at 157.

[28] Proposal at 176-188.

the specific disclosure of classification information with narrative disclosure concerning the fund's overall liquidity program.[29]

The SEC notes that the years of experience that funds have gained in complying with Rule 22e-4 have rendered the concerns that led to the SEC's removal of liquidity classification information from N-PORT less relevant, and the SEC's proposed aggregate liquidity disclosure could improve the mix of information available to investors.[30] Liquidity classifications for individual fund investments and the number of days a fund's holdings fell below a fund's HLIM will remain non-public.

OTHER PROPOSED N-PORT AMENDMENTS

In addition to the proposed amendments to Form N-PORT noted above, the SEC proposed the following additional amendments to Form N-PORT:

- Funds will be required to report information about the number of times the fund applied a swing factor during the month and the amount of each swing factor applied;
- Funds will be required to report information regarding fund flows for the month that the Form N-PORT report covers (rather than for the preceding three months, as currently required);
- Part F of Form N-PORT will be amended to require funds to report complete portfolio holdings for the period covered by the N-PORT report within 60 days of month-end, except for N-PORT reports covering a fund's second and fourth fiscal quarters (i.e., funds will be required to file complete portfolio holdings 10 times per year);
- Part D of Form N-PORT will be amended to require monthly reporting of information about miscellaneous securities (currently only required for the last month of the fiscal quarter). While detailed information reported in Part D will remain nonpublic, funds will be permitted to publicly disclose the aggregate amount of miscellaneous securities held in Part C of Form N-PORT; and
- Information reported by open-end funds about collateral posted as margin or collateral in connection with certain derivative transactions would be revised. Under the Proposal, funds would be required to report the value of its highly liquid investments that are posted as margin or collateral in connection with moderately liquid or illiquid investments, and would require a fund to report the value of any margin or collateral posted in connection with an illiquid derivatives transaction, where the fund would receive the value of the margin or collateral if it exited the derivatives transaction. In addition, information currently reported related to a fund's highly liquid investments would be revised to reflect that not all highly liquid investments will count toward the fund's HLIM.

29 The requirements to provide narrative information in a fund's shareholder report about how the fund manages its liquidity were recently eliminated based on staff observations and feedback indicating the narrative disclosure failed to meaningfully augment other information already available to shareholders. *See* Tailored Shareholder Reports for Mutual Funds and Exchange-Traded Funds; Fee Information in Investment Company Advertisements, Investment Company Act Release No. 34731 (Oct. 26, 2022).

30 Proposal at 217

CONCLUSION

The Proposal, if adopted as proposed, would represent significant changes to the operations, distribution, and, in some cases, the investment strategies of open-end mutual funds. The amendments to Rule 22e-4 and Rule 22c-1 would require substantial operational and technology adjustments in order to comply with the adjusted liquidity framework, which the SEC acknowledges will likely result in significant costs.[31] In addition, the movement of investments currently classified as Less Liquid Investments into the Illiquid Investments category, which is subject to a 15% limitation on investment, will have material impacts on funds that currently invest significant portions of their portfolios in Less Liquid Investments, such as bank loan funds, unless the settlement times for those investments can be dramatically reduced.

Another potential area of contention relating to the Proposal is the proposed public disclosure of aggregate liquidity classifications. This topic was subject to significant industry resistance when Rule 22e-4 was originally adopted and, indeed, led the Commission to amend the rule prior to its effective date to eliminate the public disclosure requirement. At the time, fund managers were concerned that the public disclosure of their aggregate liquidity classifications would have negative unintended consequences, potentially creating a new source of systemic risks.

Perhaps more significant, the proposed requirements with respect to swing pricing and the associated hard close requirement would have implications for the distribution of Mutual Funds, potentially excluding Mutual Funds from certain distribution channels altogether and potentially impacting the ability for Mutual Fund investors through intermediaries to transact on a same day basis.

The SEC acknowledges these challenges and makes 13 separate references to the potential for investors who may "exit mutual funds" and instead invest in other fund structures or that the changes may make Mutual Funds less attractive. As a result, investors could look to transition assets from Mutual Funds to ETFs and collective investment trusts, structures that would not be subject to the swing pricing and hard close requirements.

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31 Proposal at 360.

Morgan Lewis

CONTACTS

If you have any questions or would like more information on the issues discussed in this report, please contact any of the following Morgan Lewis lawyers:

Boston

Lea Anne Copenhefer	+1.617.951.8515	leaanne.copenhefer@morganlewis.com
Lance C. Dial	+1.617.341.7727	lance.dial@morganlewis.com
Barry N. Hurwitz	+1.617.951.8267	barry.hurwitz@morganlewis.com
Jeremy B. Kantrowitz	+1.617.951.8458	jeremy.kantrowitz@morganlewis.com
Roger P. Joseph	+1.617.951.8247	roger.joseph@morganlewis.com
Toby R. Serkin	+1.617.951.8760	toby.serkin@morganlewis.com
Mari Wilson	+1.617.951.8381	mari.wilson@morganlewis.com
Ellen Blanchard	+1.617.341.7505	ellen.blanchard@morganlewis.com
Amy C. McDonald	+1.617.341.7810	amy.mcdonald@morganlewis.com

New York

Elizabeth L. Belanger	+1.212.309.6353	elizabeth.belanger@morganlewis.com

Orange County

Laurie A. Dee	+1.714.830.0679	laurie.dee@morganlewis.com

Philadelphia

David W. Freese	+1.215.963.5862	david.freese@morganlewis.com
Sean Graber	+1.215.963.5598	sean.graber@morganlewis.com
Timothy W. Levin	+1.216.963.5037	timothy.levin@morganlewis.com
John J. O'Brien	+1.215.963.4969	john.obrien@morganlewis.com

Washington, DC

Mana Behbin	+1.202.373.6599	mbehbin@morganlewis.com
Laura E. Flores	+1.202.373.6101	laura.flores@morganlewis.com
Thomas S. Harman	+1.202.373.6725	thomas.harman@morganlewis.com
W. John McGuire	+1.202.373.6799	john.mcguire@morganlewis.com
Christopher D. Menconi	+1.202.373.6173	christopher.menconi@morganlewis.com
Beau Yanoshik	+1.202.373.6133	beau.yanoshik@morganlewis.com
Abigail Bertumen	+1.202.739.5988	abigail.bertumen@morganlewis.com
Kathleen M. Macpeak	+1.202.373.6149	kathleen.macpeak@morganlewis.com
Monica Lea Parry	+1.202.373.6179	monica.parry@morganlewis.com
Magda El Guindi-Rosenbaum	+1.202.373.6091	magda.elguindi-rosenbaum@morganlewis.com
K. Michael Carlton	+1.202.373.6070	michael.carlton@morganlewis.com
Philip Smith	+1.202.739.5503	philip.smith@morganlewis.com

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APPENDIX A – KEY CHANGES IN THE PROPOSAL

Item	Existing Rule	Proposed Amendments
Overall Classification Framework	Four Categories: - Highly Liquid - Moderately Liquid - Less Liquid - Illiquid	Eliminates "Less Liquid Investments" and may move these investments to the "Illiquid Investments" category
Liquidity Determination: Size	Reasonably Anticipated Trade Size (RATS)	10% of **each** portfolio investment
Liquidity Determination: Assessing Significant Market Impact	Allows flexibility in measuring and determining market impact	20% of 20-day ADTV for equities 1% price impact for fixed income securities
Liquidity Determination: Fair Valued Investments	N/A	Adding fair valued
Liquidity Determination: Classification Frequency	At least monthly	Required daily
Primarily Highly Liquid	Funds that are deemed to be "primarily highly liquid" are exempt from HLIM	Primarily highly liquid exemption eliminated
Liquidity-Related Investment Restrictions: Highly Liquid Investment Minimums	Set by fund, if applicable	All funds required to set an HLIM, minimum 10% of net assets
Liquidity-Related Investment Restrictions: Illiquid Limitation	Margin/collateral not included	Include margin/collateral
Swing Pricing	Optional	Required for open-end mutual funds other than ETFs and MMFs
Hard Close	N/A	Required for open-end mutual funds other than ETFs and MMFs
N-PORT Reporting Frequency	Quarterly with a 60-day delay; public access to some information for the third month of each quarter	Monthly within 30 days of month end, which would be followed by public availability of much of the reported information 60 days after month end
N-PORT Reporting – Liquidity Classifications	Non-public	Information regarding the aggregate percentage of a fund's portfolio classified in each of the three proposed liquidity categories would be publicly available