

Checked Swing—SEC Does Not Adopt "Swing Pricing" or a "Hard Close" for Now, but Only Provides Liquidity Guidance and Amendments to Forms N-Port and N-Cen

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EXECUTIVE SUMMARY

On 28 August, 2024, the Securities and Exchange Commission (SEC) adopted amendments to reporting forms for registered investment companies (funds)¹ that will (1) require funds to file monthly (rather than quarterly) reports of their portfolio holdings and other data on Form N-PORT within 30 days after month's end; (2) make monthly Form N-PORT data publicly available with a 60-day delay; and (3) amend Form N-CEN to require open-end funds with liquidity risk management programs to identify and provide information about third-party service providers that such funds use to comply with Rule 22e-4 (the Liquidity Rule) under the Investment Company Act of 1940.

The SEC also provided guidance about open-end funds' administration of their liquidity risk management programs but declined to adopt its controversial proposals requiring open-end funds to use "swing pricing" and implement a "hard close" for trading fund shares.² "Swing pricing" is the adjustment of a fund's price above or below its net asset value per share, which is intended to pass on the costs arising from shareholder purchase or redemption activity to the shareholders engaging in that activity and mitigate the dilution of existing shareholders' investment. The "hard close" for trading fund shares – effectively imposing a single cut-off time for receipt of purchase or sale orders by a fund transfer agent or a registered clearing agency in order to transact at that day's price – is intended to facilitate the operation of swing pricing, which requires more reliable and timely information about fund inflows and outflows than funds can obtain currently. These proposals would have applied to all open-end investment companies but not money market funds or exchange-traded

funds (ETFs). The SEC also declined to adopt amendments to the Liquidity Rule to change how open-end funds classify the liquidity of their investments and require such funds to determine and maintain a minimum amount of highly liquid assets of at least 10% of net assets. The industry widely opposed the swing pricing and hard close proposals, which the SEC issued in November 2022 as part of a package that included the Form N-PORT and N-CEN amendments. The swing pricing and hard close reforms, as well as the Liquidity Rule amendments, remain on the SEC's rulemaking agenda for spring 2025 for potential re-proposal. Public remarks in 2024 by SEC Chairman Gary Gensler and members of the SEC staff suggest that the SEC would move away from mandatory swing pricing and instead consider proposing alternative measures, such as mandatory liquidity fees, but it remains to be seen what approach will ultimately prevail.

The decision not to move forward with the swing pricing and hard close requirements as originally proposed is a welcome development for the mutual fund industry. However, the new amendments to Forms N-PORT and N-CEN will impose additional operational and cost burdens on funds, as funds will need to compile, prepare, and file Form N-PORT data on an accelerated schedule. The amount of a fund's N-PORT data that is publicly available on an annual basis will effectively triple, as public reports will increase from quarterly to monthly. The SEC states in the adopting release that the prior quarterly N-PORT reporting regime "limited [its] ability to develop a timely and more complete understanding of the market, thereby impeding its ability to respond to market stresses and events" such as market disruptions related to the COVID-19 pandemic that began in March 2020, the Russian invasion of Ukraine in 2022, the transition away from the London Interbank Offered Rate, and the regional bank crisis in spring 2023. The SEC asserts that more frequent and timely reporting of fund portfolio holdings data will allow the SEC to "(1) conduct more targeted and timely monitoring efforts; (2) analyze risks and trends more accurately; and (3) better assess the breadth and magnitude of potential impacts of market events and stress affecting particular issuers, asset classes, counterparties, or market participants."

Amendments to Reporting Requirements

Generally as proposed, the amendments will update certain reporting requirements on Forms N-PORT and N-CEN as further detailed below. The SEC believes that these changes will improve transparency for fund investors and provide the SEC with more frequent and timely information about the funds' portfolio holdings and Liquidity Service Providers (as defined below). The SEC intends to use this information to enhance its ability to oversee the fund industry and to assess trends and risks.

Form N-PORT Filing and Publication Frequency

Reports on Form N-PORT provide monthly information about a fund's complete portfolio holdings, as well as related information to help assess a fund's risks, including investment risks (e.g., interest rate risk, credit risk, and volatility risk), liquidity risk, counterparty risk, and leverage.

The SEC adopted amendments to Form N-PORT, and related Rule 30b1-9 under the Investment Company Act of 1940, to increase the frequency of reporting requirements for funds that file such form. Currently, funds are required to make a quarterly filing on Form N-PORT that includes, among other things, the funds' portfolio holdings as of the last business day, or last calendar day, of each month end during the quarter, with only the holdings information for the third month of each fund's fiscal quarter being made public. These filings are due 60 days after each quarter end. Under the amendments, these filings will be made on a monthly basis and due within 30 days of month end with the expectation that they be made public 60 days after month end. However, reported information that is currently nonpublic, including liquidity classifications for individual portfolio investments, will

remain nonpublic in individual reports.

The amendments also include technical changes to align reporting requirements with a monthly rather than quarterly filing schedule and to address which information will or may remain nonpublic now that all three months of reports will be publicly accessible.

The impact of the Form N-PORT amendments will vary by fund as shorter filing timelines may have a greater impact and burden for funds with complex investment strategies. The availability of more frequent and closer to current public reporting also raises concerns regarding potential front-running of fund strategies.

Form N-CEN Liquidity Service Provider Information

The SEC also adopted amendments to Form N-CEN to require funds that are subject to the Liquidity Rule to identify and provide certain information about third-party service providers that such funds use to fulfill the requirements of the Liquidity Rule (Liquidity Service Providers).

The amendments will require a fund to: (1) name each Liquidity Service Provider; (2) provide identifying information, including the legal entity identifier, if available, and address for each Liquidity Service Provider; (3) identify if the Liquidity Service Provider is affiliated with the fund or its investment adviser; (4) identify the asset classes for which that Liquidity Service Provider provided classifications; and (5) indicate whether the Liquidity Service Provider was hired or terminated during the reporting period. The amendments will enable the SEC to track and analyze funds' liquidity classification practices by requiring information about whether and which Liquidity Service Providers are used, for what purpose, and for what period. The collection of this information will not be kept confidential, and the collection will be mandatory.

Guidance on Certain Open-End Fund Liquidity Risk Management Program Requirements

While the SEC did not adopt amendments to the Liquidity Rule at this time, it provided guidance for funds subject to the Liquidity Rule to address questions raised through the SEC staff's outreach and monitoring. As it stands, the Liquidity Rule requires open-end funds: (1) to review liquidity classifications more frequently than monthly if there are relevant market, trading, and investment-specific considerations that may materially affect one or more of the investment classifications; (2) to consider the time in which a fund can reasonably expect an investment to be "convertible to cash" (i.e., sold and settled) without significantly changing the market value of the investment; and (3) to set a highly liquid investment minimum to the extent a fund does not primarily hold assets that are highly liquid investments.

Frequency of Classification

The SEC highlights the importance of liquidity classifications as the basis for determining if a fund continues to comply with the Liquidity Rule's 15% illiquid investment limit and with a fund's highly liquid investment minimum, if applicable. The SEC reiterates that a fund's liquidity risk management policies and procedures should be reasonably designed to perform any required intra-month review of liquidity classifications and generally should identify, for example, the type of information a fund will use to identify relevant intra-month changes and to review liquidity classifications intra-month, as well as the timeliness of that information. The SEC notes the SEC staff observed multiple instances where funds were not prepared to review classifications intra-month in response to such changes. The SEC provides examples of changes in market, trading, and investment-specific considerations that may

prompt an intra-month review of liquidity classifications. For example, if a fund substantially increases the position size of an existing investment, the fund should consider whether the larger anticipated trading size of that investment would make it more difficult to sell and impact the liquidity classification. In addition, a fund should consider whether a newly acquired investment is reasonably expected to materially affect the liquidity profile of the fund, and if so, the fund should consider classifying the new investment intra-month.

Meaning of “Cash”

The SEC clarifies that the term “cash,” as used in the Liquidity Rule, means US dollars and does not include foreign currencies or cash equivalents. The SEC stresses in the guidance that funds should not base liquidity determinations in an international jurisdiction on the ability to sell, dispose of, or settle an investment into the local currency without also considering the ability to convert the local currency into US dollars for purposes of paying shareholder redemptions.

Specifically, the SEC provides guidance on what funds should take into consideration when determining the time in which an international investment would be convertible to US dollars. Funds should consider: (1) reasonable expectations of the period in which an international noncurrency investment can be sold and settled in the local market without significantly changing the market value of the investment; and (2) reasonable expectations of the period of time in which any international currency received upon settlement can be converted to US dollars without significantly changing the currency exchange rate.

Certain jurisdictions may also impose currency controls or other limitations that should be considered as part of a fund's liquidity risk management. If a fund does not reasonably expect to be able to convert the local currency into US dollars within seven calendar days because of currency controls or otherwise, then holdings of the local currency should be classified as an illiquid investment. Further, other investments in that jurisdiction that would be sold or disposed of in exchange for the illiquid local currency also should be classified as illiquid investments.

Highly Liquid Investment Minimums

The Liquidity Rule requires a fund that does not primarily hold assets that are highly liquid investments to set a highly liquid investment minimum. The SEC reiterates that, when considering a fund's investment strategy and portfolio liquidity, a fund that invests significantly in less liquid or illiquid investments, such as a bank loan fund, generally should consider establishing a highly liquid investment minimum that is higher than that of a fund that is more liquid. This position also applies to funds with investment strategies that have had greater volatility of flows than other investment strategies—or that are reasonably expected to have greater volatility in reasonably foreseeable circumstances.

The SEC emphasizes that the goal of a highly liquid investment minimum is to increase the likelihood that a fund will be prepared to meet redemptions without significant dilution. Furthermore, the SEC notes this requirement does not mean that a fund should only, or primarily, meet redemption requests through its most liquid investments or that a fund must continuously maintain a specific level of highly liquid assets and cannot use those assets to meet redemptions.

COMPLIANCE DATES

The amendments will become effective on 17 November 2025, and funds generally will be required to

comply in Form N-PORT and N-CEN reports filed on or after that date, except for filers that are considered smaller entities, which will have an additional six-month compliance period until 18 May 2026 to comply with the Form N-PORT amendments. Smaller entities are funds that, together with other investment companies in the same “group of related investment companies” (as such term is defined in Rule 0-10 under the Investment Company Act of 1940), have net assets of less than US\$1 billion as of the end of the most recent fiscal year.

During the additional six-month compliance period, smaller entities should continue to maintain records of Form N-PORT information within 30 days after month end as required by Rule 30b1-9 unless and until the earlier of (1) the compliance date for smaller entities or (2) the first month such a fund begins to file monthly reports on Form N-PORT within 30 days of month end before that date.

Recommended Next Steps

In light of the amendments and Liquidity Rule guidance, funds and their boards may wish to consider, among other things:

- Preparing operationally for the collection, compilation, accuracy review, and filing of Form N-PORT in compliance with the accelerated filing schedule;
- Reviewing current portfolio holdings disclosure policies and procedures (and related fund registration statement disclosure) to determine whether any updates are needed to incorporate the new reporting requirements;
- Reviewing the fund’s liquidity risk management program and related policies and procedures to confirm such policies and procedures align with the Liquidity Rule guidance and to identify any gaps that need to be addressed;
- Confirming that any Liquidity Service Providers that the fund uses are aware of and factor into their monitoring responsibilities the aspects of the Liquidity Rule highlighted by the guidance and described above; and
- Continuing to monitor the operation of the fund’s liquidity risk management program, as topics related to fund liquidity risk remain on the SEC’s regulatory agenda for spring 2025 for potential re-proposal. The SEC’s original concern was driven by the market events that began to unfold in March 2020. Certain segments of the fund market witnessed large-scale investor outflows, which placed pressure on these funds to generate liquidity quickly in order to meet investor redemptions. The SEC asserts that these large outflows, combined with the widening bid-ask spreads funds encountered when purchasing or selling portfolio investments at that time, likely contributed to dilution of the value of funds’ shares for remaining investors. While the Liquidity Rule guidance with respect to liquidity classifications, particularly intra-month classifications, may mitigate some of these concerns, liquidity risk management will continue to be a focus area for regulators.

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