

CLIENT ALERT

# SEC Adopts Amendments on Forms N-PORT and N-CEN and Issues Liquidity Rule Guidance

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On August 28, 2024 in a 3 to 2 vote, the U.S. Securities and Exchange Commission (“SEC” or “Commission”) adopted amendments (the “Final Amendments”) to the reporting requirements on Forms N-PORT and N-CEN that apply to certain registered investment companies, including registered open-end funds, registered closed-end funds, and unit investment trusts under the Investment Company Act of 1940, as amended (the “1940 Act”).<sup>1</sup> The Final Amendments require more frequent reporting of monthly portfolio holdings and related information to the SEC and the public, amend certain reporting requirements relating to entity identifiers, and require open-end funds to report information about service providers used to comply with liquidity risk management program requirements.<sup>2</sup> In addition, the SEC provided guidance related to open-end fund liquidity risk management program requirements.

Notably, the SEC did not adopt all of the proposed amendments (the “Proposed Amendments”) from the November 2022 proposal (the “Proposal”). In particular, the SEC did not adopt requirements for the use of “swing pricing” and a “hard close” time for mutual funds. Further, while the SEC did not adopt amendments that would have made changes to Rule 22e-4’s (the “Liquidity Rule”) liquidity classification framework (among other elements), the SEC did provide guidance related to the frequency of classifying the liquidity of fund investments, the meaning of cash relating to the liquidity of certain non-U.S.

<sup>1</sup> Form N-PORT and Form N-CEN Reporting; Guidance on Open-End Fund Liquidity Risk Management Programs, Release No. IC-35308 (Aug. 28, 2024), available at <https://www.sec.gov/files/rules/final/2024/ic-35308.pdf> (“Adopting Release”).

<sup>2</sup> The SEC identified certain reasons for adopting the Final Amendments, largely due to market data transparency issues around the beginning of the COVID-19 pandemic, the Russian invasion of Ukraine in February of 2022, the LIBOR transition, and market stress relating to particular issuers or asset classes (e.g., Spring 2023 insolvency of regional banks) where data could not be fully analyzed at the time of these events. *Id.* at 8-9.

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investments, and determining and reviewing highly liquid investment minimums (“HLIMs”). The Proposed Amendments not adopted by the Commission received significant opposition from industry participants citing potential increased operational and compliance costs. Nevertheless, the SEC’s regulatory agenda indicates certain elements of the Proposal may be re-proposed next year and liquidity risk management is a stated priority of the SEC’s Division of Examinations in 2024.<sup>3</sup>

### Amendments to Form N-PORT

Under current Rule 30b1-9, registered management investment companies and exchange-traded funds organized as unit investment trusts (hereinafter collectively referred to as “funds”) must file reports on Form N-PORT about their portfolios as of month end on a quarterly basis, and the funds have up to 60 days after the end of a quarter to file Form N-PORT.<sup>4</sup> Currently, only information for the third month of each quarter is publicly available, while information for the first two months of each quarter is confidential.

The Final Amendments now require funds to file Form N-PORT on a monthly basis within 30 days of the month’s end with the SEC. The filings will become publicly available 60 days following the end of each month.<sup>5</sup>

Further, the Commission adopted, as proposed, requirements that a fund report certain return and flow information only for the month that the Form N-PORT report covers, rather than requiring that information for the preceding three months.<sup>6</sup> The SEC also adopted, as proposed, Final Amendments to Part D of Form N-PORT that remove language limiting reporting of nonpublic information about individual miscellaneous securities holdings to reports filed for the last month of each fiscal quarter.<sup>7</sup>

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<sup>3</sup> See Spring 2024 Unified Agenda of Regulatory and Deregulatory Actions, Regulation Identification No. (RIN) 3235-AM98 (July 8, 2024), *available at* <https://www.reginfo.gov/public/do/eAgendaViewRule?publd=202404&RIN=3235-AM98>; U.S. Securities and Exchange Commission Division of Examinations 2024 Examination Priorities (Oct. 16, 2023), *available at* <https://www.sec.gov/files/2024-exam-priorities.pdf>; See Willkie Farr & Gallagher LLP, Client Memorandum: SEC Charges Investment Adviser, Officers and Fund Trustees with Liquidity Rule Violations (Mar. 2023), *available here*. This alert covers the SEC’s first case enforcing the Liquidity Rule following its compliance date. The enforcement action charged, in part, that the Fund failed to develop a plan to bring its position in illiquid investments into compliance with the 15% net asset limit as required by the Liquidity Rule.

<sup>4</sup> *Id.* at 5. As originally adopted in 2016, funds were required to file Form N-PORT within 30 days of month’s end. However, an interim final rule was adopted requiring only quarterly filing within 60 days as a result of the SEC’s re-evaluation of its internal cybersecurity risk profile. See Adopting Release at 6-7.

<sup>5</sup> The SEC did not adopt its Proposed Amendments which would have required a fund to attach its complete portfolio holdings in accordance with Regulation S-X within 60 days of the end of the reporting period for each month. Additionally, funds will not be required to report swing pricing-related information on Form N-PORT, as the Proposed Amendments related to swing pricing were not adopted.

<sup>6</sup> Adopting Release at 44.

<sup>7</sup> *Id.* at 45.

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### Amendments to Form N-CEN

The Final Amendments require funds that are subject to the Liquidity Rule to identify and provide certain information about service providers a fund uses to fulfill the requirements of the rule. Specifically, with respect to liquidity service providers, a fund is now required to: (1) name each liquidity service provider; (2) provide identifying information, including the legal entity identifier (“LEI”), if available, and location, 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 service provider was hired or terminated during the reporting period.<sup>8</sup> The SEC noted that the adoption of this amendment is intended to allow the SEC (and others) to track liquidity risk management practices.<sup>9</sup>

As liquidity classification services have become more widely used, the Final Amendments require information on whether and which liquidity service providers are used, for what purpose, and for what period. In the Adopting Release, the SEC stated that the information will help it better understand potential trends or outliers in the liquidity classifications reported on Form N-PORT.<sup>10</sup> For example, the SEC believes that the information may help it analyze classification trends of specific liquidity service providers to distinguish patterns in how classifications may differ due to service provider models or data.

The Final Amendments also amend the definition of LEI in Form N-CEN to remove language which provides that, in the case of a financial institution that does not have an assigned LEI, a fund should instead disclose the RSSD ID assigned by the National Information Center of the Board of Governors of the Federal Reserve System, if any.<sup>11</sup> The Final Amendments will now require that funds identify specifically whether they are reporting an LEI or an RSSD, if available. However, the Final Amendments will not change the circumstances in which a fund is required to report an LEI or an RSSD ID, if available. The SEC stated that this change is designed to improve consistency and comparability of information that funds report about the instruments they hold, including issuers of those instruments and counterparties to certain transactions.<sup>12</sup>

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

In addition to the regulatory amendments, the SEC provided guidance for funds subject to the existing Liquidity Rule to address questions raised through outreach and monitoring.

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<sup>8</sup> *Id.* at 47-48.

<sup>9</sup> The SEC did not adopt a Proposed Amendment to remove swing pricing disclosure from Form N-CEN, which is found at Item C.21 of the Form.

<sup>10</sup> Adopting Release at 47-48.

<sup>11</sup> *Id.* at 46.

<sup>12</sup> *Id.* at 46-47.

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### *Frequency of Classification*

Under the Liquidity Rule, funds must review liquidity classifications more frequently than monthly 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. Funds must adopt policies and procedures "reasonably designed" so that the funds can conduct the required intra-month review of liquidity classifications in the event that there are changes in market, trading, and investment-specific conditions.<sup>13</sup>

The SEC previously provided guidance and examples of changes in market, trading and investment-specific considerations for funds to consider when determining when and whether to review liquidity classifications. In addition to the previous guidance, the SEC provided new examples of considerations, such as:

- On size of position: If a fund substantially increases the size of its position in an investment, the fund may reasonably anticipate trading a larger size of the investment, which could materially affect the liquidity classification.<sup>14</sup>
- On intra-month acquisitions: A fund should generally consider classifying newly acquired investments intra-month if acquiring a particular investment is reasonably expected to result in material changes to the liquidity profile of a fund, particularly changes to the fund's liquidity profile that may cause a shortfall below a fund's highly liquid investment minimum or exceed the limit on illiquid investments.<sup>15</sup>

### *Meaning of Cash*

The Liquidity Rule requires a fund to consider the time in which it reasonably expects an investment to be "convertible to cash" without significantly changing the market value of an investment in order to determine whether an investment can be classified as highly liquid or moderately liquid.<sup>16</sup> The SEC provided guidance that "cash" under the Liquidity Rule means U.S. dollars and does not include foreign currencies or cash equivalents.

For investments that are non-U.S. dollar currencies, the SEC stated that a fund would need to consider the amount of time it is reasonably expected to take to convert a reasonably anticipated trade size of that currency into U.S. dollars under current market conditions without significantly changing the currency exchange rate.<sup>17</sup> Relevant factors to consider generally

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<sup>13</sup> Such policies and procedures 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.

<sup>14</sup> Adopting Release at 50.

<sup>15</sup> *Id.*

<sup>16</sup> *Id.* at 51.

<sup>17</sup> *Id.* at 52.

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include the presence of currency controls, the presence of an active market in forward or spot contracts exchanging the currency for U.S. dollars, and any delays in currency conversions driven by market structure or operations.

When considering the time in which a non-U.S. investment (other than a non-U.S. currency) would be convertible to U.S. dollars, the SEC provided that funds generally should take into account two considerations: (1) the reasonable expectations of the period of time in which a non-U.S., non-currency investment can be sold and settled in a local market without significantly changing the market value of the investment and (2) reasonable expectations of the period of time in which any non-U.S. currency received upon settlement can be converted to U.S. dollars without significantly changing the currency exchange rate.<sup>18</sup> If a fund does not reasonably expect to be able to convert a local currency into U.S. dollars within the seven-calendar-day time frame, the SEC stated that that currency should be classified as an illiquid investment. The guidance on the meaning of cash will be particularly relevant for funds that invest in emerging or frontier markets that have currencies that are subject to currency controls.

### *Highly liquid investment minimums*

The Liquidity Rule requires funds that do not primarily hold assets that are highly liquid investments to have a highly liquid investment minimum. The SEC emphasized and reiterated the importance of a highly liquid investment minimum that considers a fund's particular risk factors.

For example, the SEC has stated in prior guidance 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. In addition, the SEC stated that 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—would generally need highly liquid investment minimums that are higher than funds whose strategies tend to entail less flow volatility.<sup>19</sup> Further, while a line of credit or similar arrangement can facilitate a fund's ability to meet unexpected redemptions and can be taken into consideration when determining its highly liquid investment minimum, the SEC stated that it continues to believe that liquidity risk management is better conducted primarily through construction of a fund's portfolio.

The SEC also clarified that the highly liquid investment minimum is not intended to mean that a fund should only, or primarily, use its most liquid investments to meet shareholder redemptions.<sup>20</sup> In addition, the SEC stated that the requirement does not mean that a fund must continuously maintain a specific level of highly liquid assets and cannot use those assets to meet redemptions.

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<sup>18</sup> *Id.*

<sup>19</sup> Adopting Release at 56.

<sup>20</sup> *Id.*

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### Summary of Key Proposed Amendments That Were Not Adopted

When the Proposal was published in 2022, several key industry leaders voiced fervent opposition to the Proposed Amendments, mainly swing pricing, the hard close requirements for mutual funds, and the various proposed changes to the Liquidity Rule.

#### *Swing Pricing*

Swing pricing is the process of adjusting a mutual fund's current net asset value ("NAV") per share at which transactions in fund shares are priced when certain conditions are met, such that the transaction price effectively passes on costs stemming from shareholder inflows or outflows to purchasing and redeeming shareholders, as applicable.<sup>21</sup> In 2016, the SEC amended Rule 22c-1 to provide funds with the option to use swing pricing. Had the Proposal's swing pricing rule been adopted, Rule 22c-1 would require all open-end funds other than money market funds and ETFs to engage in swing pricing under certain circumstances.

#### *Hard Close Requirement*

Rule 22c-1 prohibits an open-end fund from selling or redeeming its shares other than at a price based on the current NAV of the fund next calculated after the fund receives the investor's purchase or redemption order. Mutual funds typically calculate their NAVs at 4 p.m., ET. When an investor submits an order to purchase or redeem fund shares through a financial intermediary, current SEC staff guidance permits the order to be executed based on the current day's NAV as long as the intermediary received the order before the fund calculated its NAV, even if the fund receives the order after it calculates the current day's NAV. Funds often receive orders from intermediaries hours after their NAVs are calculated, sometimes as late as the next morning. As a result, funds typically do not have complete investor flow information for a given day prior to calculating NAV for the day.

In order to facilitate the previously proposed mandatory swing pricing framework, the Proposed Amendments included a "hard close" requirement for all mutual funds that would be subject to the swing pricing requirement. The hard close requirement would have provided that all eligible orders received by a fund, its designated transfer agent, or clearing agency before the fund's pricing time (i.e., the time at which the fund calculates its NAV) will receive the current day's price; any orders received after the fund's pricing time would receive the next day's price.

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<sup>21</sup> Willkie Farr & Gallagher LLP, Client Memorandum: SEC Proposes Amendments to Liquidity Risk Management Programs and Adoption of Swing Pricing and Hard Close Requirements for Open-End Funds (Dec. 21, 2022) available at <https://www.willkie.com/-/media/files/publications/2022/secproposesamendmentstoliquidityriskmanagementprog.pdf>.

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### *Liquidity Rule Proposed Amendments*

While the SEC provided guidance related to the Liquidity Rule (as discussed above), the Commission did not adopt the Proposed Amendments from the Proposal related to the Liquidity Rule's liquidity classification categories,<sup>22</sup> the determination of liquidity classifications, and the highly liquid investment minimum.

Under the Proposed Amendments, the "less liquid" investment classification would have been subsumed into the "illiquid investment" classification, and the "moderately liquid investment" classification would have been modified to serve as a catchall category for any investment that was not a "highly liquid investment" or an "illiquid investment."<sup>23</sup> Additionally, the "illiquid investment" classification would have been expanded to include any investment the fund reasonably expected not to be convertible to U.S. dollars in current market conditions in seven calendar days or less without significantly changing the market value of the investment and any investment whose fair market value is measured using an unobservable input that is significant to the overall measurement.<sup>24</sup>

The Proposed Amendments would have also:

- Required funds (other than in-kind ETFs) to classify each individual portfolio investment on each business day, rather than being permitted to classify portfolio investments by asset class on a monthly basis,
- Replaced the current reasonably anticipated trade size ("RATS") standard with a set "stressed trading size," and
- Removed the exclusion from the requirements applicable to HLIMs for funds that primarily hold highly liquid assets and instead require all funds, other than in-kind ETFs, to determine and maintain an HLIM of at least 10% of net assets, among other things.

### **Effective Dates**

The amendments will become effective November 17, 2025. Funds generally will be required to comply with the Final Amendments for reports filed on or after that date, except fund groups with net assets of less than \$1 billion will have until May 18, 2026 to comply with the Form N-PORT amendments.<sup>25</sup>

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<sup>22</sup> Under the Liquidity Rule, each fund, other than an in-kind ETF, must review periodically the liquidity risk of its portfolio investments and classify portfolio investments into one of four liquidity classifications: "highly liquid investment," "moderately liquid investment," "less liquid investment" or "illiquid investment." 17 CFR § 270.22e-4(b)(1)(ii).

<sup>23</sup> Willkie Farr & Gallagher, *supra* note 21, at 4.

<sup>24</sup> *Id.*

<sup>25</sup> Adopting Release at 1.

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### Conclusion and Takeaways

In preparation for the effective dates of the Final Amendments, funds should consider reviewing their policies and procedures to ensure that they will be prepared to file Form N-PORT on a more frequent basis and coordinate with their liquidity service providers to comply with the disclosure changes to Form N-CEN. Funds, and especially those funds that engage in significant investments that are non-U.S. dollar currencies or in emerging or frontier markets, should carefully consider the guidance with respect to the meaning of cash and how that guidance may affect their liquidity risk management programs. Fund managers should continue to expect compliance with the Liquidity Rule and funds' liquidity risk management programs to remain a focus for the SEC in examinations of registered investment companies. In addition, although the SEC did not adopt certain of the significant changes proposed as a part of the Proposed Amendments, the SEC may revisit certain of the Proposed Amendments in future rulemaking and propose other additional amendments to the Liquidity Rule.

If you have any questions regarding this client alert, please contact the following attorneys or the Willkie attorney with whom you regularly work.

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