Liquidity Risk Management Rule: The Piwowar Postscript

July 3, 2018 - On June 28th, the SEC approved amendments to the Open End Fund Liquidity Risk Management Rule (“the rule”), which theoretically could impact loan mutual funds. Below, we discuss the changes in the rule, why they are coming now – and why they might not have a substantial impact on loan mutual funds.

First, why now? This is Commissioner Michael Piwowar’s last week at the SEC. Once he steps down, the Commission will have two Democratic Commissioners (Kara Stein and Robert Jackson), one Republican Commissioner (Hester Pierce) and Republican-leaning Independent (Chairman Jay Clayton). With the SEC potentially politically deadlocked, it might not be able to make sweeping changes until a replacement commissioner is appointed.

And so, on June 28th, the SEC cleared out a significant backlog of work, including five rule amendments. One set of amendments addressed the Liquidity Risk Management Rule. Specifically, that amendment would do three things. First, it replaced a requirement that funds publicly report aggregate liquidity classifications of investments in Form N-PORT with a requirement that funds discuss their liquidity risk management programs in their annual or semi-annual reports. Second, the amendment would allow funds to split their holdings into more than one liquidity classification. (This could happen, for instance, if a portion of the holding could be sold and settled in less than three days, but the remainder of the holding would take longer to sell and settle). Third, funds will now be required to disclose their holdings of cash or cash equivalents. (In addition, the SEC already had provided a six-month extension for some reporting requirements.)

While these refinements are sensible, they are not particularly loan centric. As background, the rule requires funds to split their holdings into four liquidity buckets: 1) Highly liquid investments that could be sold and settled within three days. 2) Moderately liquid investments that could be sold and settled in four to seven days. 3) Less liquid investments that could be sold within seven days, but will take longer to settle. 4) Illiquid investments that cannot not be sold within seven days without substantially changing their price. In the final rule, the SEC identified loans as a type of asset that likely would be in Bucket Three, the “Less Liquid Investments” category. Most loan fund managers have accepted that loans would likely be in Bucket Three and were less focused on splitting investments between different categories. Nonetheless, having more flexibility to describe liquidity strategies and not being required to publicly bucket assets without explaining their strategy still may be helpful for loan fund managers.