GODFREY & KAHN S.C.

Investment Management Focus

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Legal and Regulatory Update

Latest Developments

SEC Delays Form N-PORT Filing Requirement

On December 8, 2017, the SEC adopted a temporary rule delaying the compliance date for filing Form N-PORT for larger fund groups (*i.e.*, investment companies with over $1 billion in assets). The temporary rule requires larger fund groups to maintain the information that is required by Form N-PORT in their records beginning July 30, 2018 (based on June 30 data) and to make it available to the SEC upon request in lieu of publicly filing the Form N-PORT on the EDGAR system until April 2019. Larger fund groups are now required to file their initial Form N-PORT by April 30, 2019 (as opposed to the previous July 30, 2018 compliance date), and smaller fund groups are now required to file their initial Form N-PORT by April 30, 2020 (as opposed to the previous July 30, 2019 compliance date).

The temporary rule is driven by the SEC's recognition of the importance of comprehensive data security practices and protocols for sensitive, non-public information. As disclosed in our October 2017 Update, the SEC announced that its EDGAR system was breached. Since this announcement, the SEC has launched several initiatives, including an undertaking to design measures to improve EDGAR's functionality and security that could negatively impact EDGAR's ability to validate and accept Form N-PORT filings in a timely manner. Since these initiatives are still underway and may not be fully implemented and tested before the previous compliance dates, the SEC has determined to delay by nine months the requirement that funds file reports on Form N-PORT through the EDGAR system.

The delay of the Form N-PORT compliance dates also impacts the new Liquidity Rule. Larger fund groups are required to comply with the Liquidity Rule by December 1, 2018, and larger fund groups would have been required to make certain filings pursuant to the Liquidity Rule as of January 31, 2019. However, the delay for filing Form N-PORT will provide larger fund groups with a three-month delay from reporting liquidity data on Form N-PORT until April 30, 2019. Similar to the other data required by Form N-PORT, fund groups are still required to maintain the liquidity data in their records as of the original compliance date: beginning January 31, 2019 (based on December 31, 2018 data) for larger fund groups and July 30, 2019 (based on June 30, 2019 data) for smaller fund groups.

The temporary rule also delays the rescission of current Form N-Q until May 1, 2019 (for the reporting period ending March 31, 2019) for larger fund groups and May 1, 2020 (for the reporting period ending March 31, 2020) for smaller fund groups.

The temporary rule did not impact the compliance date for Form N-CEN, which remains June 1, 2018 for all funds.

Sources: Temporary Rule 30b1-9(T) under the Investment Company Act of 1940, Release No. IC-32936 (Dec. 8, 2017), available here; SEC Modifies Approach to Form N-PORT Filing Requirements, SEC Press Release No. 2017-226 (Dec. 8, 2017), available here; ICI Memorandum "SEC Modifies Approach to Form N-PORT Filing Requirements" (Dec. 8, 2017); and Beagan Wilcox Volz, SEC's Data Reporting Rule Delay Impacts Liquidity Rule, Too, IGNITES (Dec. 11, 2017).

DOL Extends Fiduciary Rule Transition Period to July 1, 2019

In November 2017, the DOL officially extended the transition period and delayed the applicability date of the best interest contract exemption (BIC Exemption) from January 1, 2018 to July 1, 2019.

As we reported in our April 2017 Update, the expanded fiduciary definition and the "Impartial Conduct Standards" in the BIC Exemption for investment advisers and other fiduciaries who make recommendations to "retirement investors" (which includes many smaller plans, participants in a 401(k) plan, and IRA owners) went into effect June 9, 2017. The DOL simplified compliance with the BIC Exemption during the transition period from June 9, 2017 to January 1, 2018 (the transition period now extended to July 1, 2019). During the extended transition period, advisers only have to comply with the Impartial Conduct Standards and not the other conditions of the BIC exemption, such as written disclosure requirements. The Impartial Conduct Standards require advisers to adhere to a best interest standard when giving investment advice, charge no more than reasonable compensation for their services, and refrain from making misleading statements.

Between now and July 1, 2019, the DOL intends to complete an updated analysis of the likely impact of the fiduciary rule on access to retirement information and financial advice as directed by a Presidential Memorandum on February 3, 2017. See our April 2017 Update for more information regarding the Presidential Memorandum. The extension also gives the DOL time to review public comments submitted in response to its June request for information on the fiduciary rule and BIC exemption and input on possible "new and more streamlined exemptions" in connection with the use of "clean shares." See our July 2017 Update regarding the request for information. The DOL will consider whether possible changes and alternatives to exemptions would be appropriate in light of the current comment record and potential input from, and action by, the SEC, state insurance commissioners and other regulators.

The DOL also announced an extension of the temporary enforcement policy contained in Field Assistance Bulletin 2017-02 to cover the 18-month extension period. Thus, from June 9, 2017 to July 1, 2019, the DOL will not pursue claims against fiduciaries working diligently and in good faith to comply with the fiduciary rule and BIC Exemption, or treat those fiduciaries as being in violation of the fiduciary rule and BIC Exemption.

Sources: 18-Month Extension of Transition Period and Delay of Applicability Dates; Best Interest Contract Exemption (PTE 2016–01); Class Exemption for Principal Transactions in Certain Assets Between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs (PTE 2016–02); Prohibited Transaction Exemption 84–24 for Certain Transactions Involving Insurance Agents and Brokers, Pension Consultants, Insurance Companies, and Investment Company Principal Underwriters (PTE 84–24), 82 F.R. 228 (Nov. 29, 2017), available here; U.S. Department of Labor Extends Transition Period For Fiduciary Rule Exemptions, EBSA Release Number: 17-1581-NAT (Nov. 27, 2017), available here.

SEC Updates its Regulatory Agenda

On December 14, 2017, the Office of Management and Budget published its agenda of government rulemaking, listing rules that agencies, such as the SEC, intend to propose or finalize within a year. The SEC updated its regulatory agenda and most notably removed proposals to restrict funds' use of derivatives and require advisers to implement business continuity plans, while adding plans to propose a uniform fiduciary rule and modify its whistleblower program.

The derivatives rule was proposed in December 2015 and would have limited funds' use of derivatives and required stricter standards for funds' oversight of their derivatives-related risks. This item was moved to the SEC's long-term agenda, which means the SEC does not intend to propose or finalize the rule within the next year. For more information regarding the derivatives rule, please refer to our January 2016 Update. The proposed rule requiring registered investment advisers to adopt business continuity plans was removed from both the current agenda and the long-term agenda.

The most notable addition to the short-term agenda was the SEC's consideration of a uniform standard of conduct for registered investment advisers and broker-dealers that would apply to all accounts (*i.e*., retirement and non-retirement accounts), in contrast to the DOL fiduciary rule. SEC Chairman Jay Clayton invited comments on the standards of conduct for investment advisers and broker-dealers in June 2017 and later stated in October 2017 that any SEC rulemaking in the area would not replace the DOL's rule. In November (following the DOL extension of the transition period discussed above), Chairman Clayton remarked at a Managed Funds Association meeting, "I think I've been clear; we are working on a fiduciary rule and exploring it for brokers and investment advisers. It's a priority for me to address this space in light of the action that the Department of Labor took to step into this space. I think we belong in this space. And we should try and produce a rule, that, when investors see it, they are happy with." The *Wall Street Journal* reported that, according to people familiar with the matter, the SEC hopes to propose its rule by the second quarter of 2018.

Sources: Dave Michaels, 'Fiduciary Rule' Poised for Second Life Under Trump Administration, Wall Street Journal (Jan. 10, 2018); Carmen Germaine, It's Official: SEC Pushes Derivatives, Biz Continuity Rules to Back Burner, IGNITES (Dec. 15, 2017); Bruce Kelly, Day After DOL Delay, SEC's Jay Clayton Calls a Fiduciary Rule a Priority, Investment News (Nov. 28, 2017); Office of Management and Budget, Current Regulatory Plan and the Unified Agenda of Regulatory and Deregulatory Actions of the Securities and Exchange Commission (Dec. 14, 2017), available here.

SEC to Examine Mutual Fund Board Responsibilities

Dalia Blass, the new Director of the Division of Investment Management, indicated that one of her initiatives is aimed at reviewing and reevaluating the duties of mutual fund boards. She intends to conduct a "board outreach initiative" and will engage mutual fund boards and ask whether they could "benefit from recalibrating the 'what' and the 'how' of board responsibilities." She stated that the Division of Investment Management's intent with respect to this initiative is not to simply shift away board responsibilities. However, the Division of Investment Management recognizes that mutual fund board responsibilities have significantly expanded in the last 77 years.

The staff of the Division of Investment Management has begun cataloguing all of the rules, exemptions and no-action letters that impose duties on mutual fund directors. The staff's plan is to scrutinize a mutual fund board's duties from a global perspective in order to determine whether it makes sense to have mutual fund boards responsible for each of the items assigned to them. Industry observers hope the SEC will publish the compendium to help mutual fund boards determine whether they are fulfilling all of their duties and also for industry participants to have a better understanding regarding the scope of director duties.

Industry trade groups are reacting positively to Ms. Blass' proposed initiative, noting this initiative is another indication of the continued deregulation championed by the current administration in Washington. The outreach portion of Ms. Blass' plan has also received positive feedback because the SEC will be able to gather facts and hear board members' opinions regarding some or all of their duties.

Sources: Key Note Address: ICI Securities Law Developments Conference, Dalia Blass (Dec. 7, 2017), available here; Greg Saitz, Echoing Past IM Chiefs, New One Says Board Duties a Focus, BoardIQ (Dec. 19, 2017).

Hester Peirce and Robert Jackson Sworn in as SEC Commissioners

On January 11, 2018, Republican Hester Maria Peirce and Democrat Robert J. Jackson were sworn in as SEC commissioners by SEC Chairman Jay Clayton. For the first time since 2015, the SEC has a full slate of five commissioners.

Commissioner Peirce comes to the SEC from the Mercatus Center at George Mason University, where she served as a Senior Research Fellow and Director of the Financial Markets Working Group. Commissioner Jackson comes to the SEC from New York University School of Law, where he was a professor of law. He previously was professor of law and director of the Program on Corporate Law and Policy at Columbia Law School. Commissioner Jackson fills a term that expires on June 5, 2019, and Commissioner Peirce fills a term that expires on June 5, 2020.

Source: Robert Jackson and Hester Peirce Sworn In as SEC Commissioners, SEC Press Release 2018-5 (Jan. 11, 2018), available here.

Liquidity Risk Management Program Rule

SEC Issues FAQs on Liquidity Risk Management Program Rule

On January 10, 2018, the SEC's Division of Investment Management released FAQs relating to the SEC's new Liquidity Rule. Among other topics, the FAQs address compliance issues relevant to sub-advised funds. Specifically, the FAQs note that, when classifying fund investments into one of the four liquidity categories, different funds (including those within the same fund complex) may appropriately classify the same investment in different categories, based on the facts and circumstances informing the analysis. Additionally, in a manager-of-managers structure, sub-advisers that manage different sleeves of a single fund may classify the same investment in different categories. The SEC staff indicates that, in such a case, neither the fund, program administrator, adviser nor sub-advisers would be under any obligation to resolve these differences for compliance purposes. However, a fund's policies and procedures could include a process for resolving such differences (*e.g.*, by stating that a specified party's determination would control in such circumstances).

Because classifications must be reported on Form N-PORT, which does not allow funds to report more than one liquidity classification for a single investment, a fund's policies and procedures must have a process for selecting a single classification for an investment for purposes of Form N-PORT reporting. The SEC staff states that a fund may use any reasonable method for resolving the difference, so long as the method is applied consistently.

Source: Investment Company Liquidity Risk Management Programs Frequently Asked Questions, available here.

Liquidity Risk Management Program Rule – Industry Feedback and Preparedness

Although the new Liquidity Risk Management Program Rule's compliance deadline is fast approaching, many fund complexes find that they still have unanswered questions and may not be as prepared as they would like. Bucketing remains the largest concern for fund groups. One of the new Liquidity Rule's requirements is that funds must classify each investment into one of four categories (or "buckets") based on the number of days within which the fund "reasonably expects" the investment to be convertible into cash or disposed of without significantly changing the market value of the investment.

The Investment Company Institute (ICI) and the U.S. Treasury Department have been openly critical of the bucketing requirement. ICI supplemented its comment letter to the SEC in November 2017 to request that the SEC delay the compliance date of the rule and ease up on some of the reporting requirements. A few of ICI's chief concerns with the bucketing requirement include the impracticality of complying with the requirement by December 1, 2018, as well as a number of vendor-related issues, where vendors need more time to improve the quality of their underlying methodologies, improve and test the delivery of data and address any gaps in asset coverage. ICI is also critical of how costly the implementation of the program is, noting that for larger fund complexes, it may cost as much as $1 million to initially comply with the bucketing requirements and approximately $500,000 annually thereafter to comply. The U.S. Treasury Department published a report in October 2017 criticizing the bucketing requirements as "overly prescriptive" despite the "fluid, and sometimes subjective, nature of liquidity," and encouraged the SEC to delay implementation of the bucketing requirement and switch to a "principles-based approach to liquidity risk management rulemaking."

Fund complexes continue to have questions with respect to whether and how to appropriately add or reassign staff in order to prepare for and comply with the new rule. The Liquidity Risk Management Program Rule requires a program administrator to oversee a fund complex's liquidity risk management program, and portfolio managers alone cannot serve as administrators, but can serve as part of a committee that administers the program. According to a survey from *Ignites,* approximately 90% of the fund complexes surveyed were considering hiring vendors to help set up and maintain systems to assist with classifying portfolio holdings in one of the four buckets. Fund complexes, depending on their size, are also considering whether to hire one specific employee to administer the program or whether to create a team from its current staff of people with trading, compliance and risk management experience.

The compliance date for fund complexes with more than $1 billion in assets is December 1, 2018. A majority of fund complexes are targeting the third quarter of calendar 2018 as the deadline for substantially completing their work in order to comply with the rule and also plan to seek final board approval at that same time. For a more complete description of the Liquidity Risk Management Program Rule and its requirements, please refer to our October 2016 Update.

Sources: Emily Laermer, Liquidity Rule 'Buckets' Are Complicated, Costly, Crummy: Industry Pros, IGNITES (Dec. 11, 2017); The Exchange, The Chief Challenges of the SEC's Liquidity Rule, IGNITES (Dec. 1, 2017); Beagan Wilcox Volz, SEC Liquidity Rule Pushes Shops to Hire Up: Survey, IGNITES (Nov. 14, 2017); ICI Again Requests Delay of Liquidity Risk Management Program Rule, Regulatory Compliance Watch (Nov. 9, 2017); ICI Supplemental Comments to SEC on Investment Company Liquidity Risk Management Programs; Request for Delay (Nov. 3, 2017); U.S. Department of the Treasury, A Financial System That Creates Economic Opportunities, Asset Management and Insurance (October 2017), available here.

Litigation and SEC Enforcement Actions and Updates

SEC Abandoning Its "Broken Windows" Approach to Enforcement

The SEC has signaled that it will dial back its prosecutorial approach to enforcement and trim its enforcement staff. SEC Co-Director of Enforcement Steven Peiken said the SEC intends to drop its "broken windows" strategy, which previously led the SEC to reprimand a large number of firms for minor legal infractions. Specifically, Mr. Peiken indicated that the SEC will pull back on conducting sweep exams in order to uncover these groups of technical violations. He stated that the Enforcement Division may be more "selective and bring a few cases to send a broader message rather than sweep the entire field."

Mr. Peiken also estimates that the size of the staff of the Enforcement Division will shrink by approximately 7%, or 100 people, by September 2018. Further, he indicated that the SEC will likely reduce the number of instances where it forces firms to admit to wrongdoing as a condition of settlement but would not abandon the practice altogether. For example, he stated that the SEC would likely require the admission of wrongdoing in cases where a defendant admitted to guilt in a related criminal case. These proposed changes signal a relatively large departure from former SEC Chair Mary Jo White's prosecutorial approach to enforcement.

Sources: Jill Gregorie, SEC to Dial Back Sweep Exams, Trim Enforcement Squad, IGNITES (Nov. 6, 2017); Dave Michaels, SEC Signals Pullback From Prosecutorial Approach to Enforcement, The Wall Street Journal (Oct. 26, 2017).

Compliance Dates for Final Rules

Final Rule	Compliance Date(s)
Amendments to Form ADV	Effective since October 1, 2017
Amendments to Books and Records Rule: Performance Information	Effective since October 1, 2017
Amendments to Form N-1A associated with liquidity rule (information regarding redemptions)	Effective since June 1, 2017 (compliance with amendments only required for registration statements filed on or after December 1, 2017)
FinCEN Clarifies and Strengthens Customer Due Diligence Requirements for Mutual Funds and Broker-Dealers	May 11, 2018
Investment Company Reporting Modernization: New Form N-CEN	June 1, 2018 for all funds (first filing date is 75 days from the end of a fund's fiscal year after June 1, 2018)
Rescission of Old Form N-SAR (N-CEN replaces N-SAR for census-type information)	June 1, 2018 for all funds
Swing Pricing	November 19, 2018 (for those funds that wish to implement swing pricing)
Amendments to Form N-1A, Regulation S-X and Form N-CEN associated with swing pricing	November 19, 2018
Liquidity Risk Management Programs (Rule 22e-4)	Fund complexes with $1 billion or more in net assets: December 1, 2018 Fund complexes with less than $1 billion in net assets: June 1, 2019
Form N-LIQUID	Fund complexes with $1 billion or more in net assets: December 1, 2018 Fund complexes with less than $1 billion in net assets: June 1, 2019
Amendments to Form N-CEN associated with liquidity rule	Fund complexes with $1 billion or more in net assets: first filing date is January 31, 2019, based on December 31, 2018 data Fund complexes with less than $1 billion in net assets: first filing date is July 30, 2019, based on June 30, 2019 data

Final Rule	Compliance Date(s)
Amendments to the certification requirements of Form N-CSR	Fund complexes with $1 billion or more in net assets: March 1, 2019 Fund complexes with less than $1 billion in net assets: March 1, 2020
Investment Company Reporting Modernization: New Form N-PORT	Fund complexes with $1 billion or more in net assets: first filing date is April 30, 2019, based on March 31, 2019 data Note that temporary rule 30b1-9(T) requires larger fund complexes to maintain in their records the information that is required to be included in Form N-PORT beginning no later than July 30, 2018, based on June 30, 2018 data in lieu of submitting the information via EDGAR. Fund complexes with less than $1 billion in net assets: first filing date is April 30, 2020, based on March 31, 2020 data
Rescission of Form N-Q (Funds are required to continue filing N-Qs until they begin filing N-PORTs)	Fund complexes with $1 billion or more in net assets: May 1, 2019 Fund complexes with less than $1 billion in net assets: May 1, 2020
Amendments to Form N-PORT associated with liquidity rule	Fund complexes with $1 billion or more in net assets: first filing date is April 30, 2019, based on March 31, 2019 data Fund complexes with less than $1 billion in net assets: first filing date is April 30, 2020, based on March 31, 2020 data Note that temporary rule 30b1-9(T) requires fund complexes to maintain in their records the information that is required to be included in Form N-PORT associated with the liquidity rule beginning no later than January 31, 2019, based on December 31, 2018 data (for larger fund complexes) and July 30, 2019, based on June 30, 2019 data (for smaller fund complexes) in lieu of submitting the information via EDGAR.