SURVEY RESULTS

ACA's Liquidity Risk Management Program Rule Survey

ACA COMPLIANCE GROUP
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I. INTRODUCTION

In response to the mutual fund industry's need for transparency and insight into how peers are approaching the Securities and Exchange Commission's (the "Commission") liquidity risk management program rule (the "liquidity program rule"), ACA Compliance Group conducted a survey of mutual fund/ETF complexes (the "fund complexes") and investment advisers/sub-advisers to mutual funds/ETFs (the "advisers"). The survey covered the following topics:

- The liquidity program administrator
- The delegation and frequency of liquidity classification
- Asset class classification
- Board of director approval of a fund's liquidity program
- "Primarily" highly liquid assets
- In-Kind ETFs

ACA received anonymous responses from 77 entities, with an almost even split between fund complexes (**32, or 42%**) and advisers (**45, or 58%**). Of the 32 participating fund complexes, 94% identified themselves as larger fund groups.[1] Of the participating advisers, 42% indicated that they manage between one and five funds, 27% manage between five and ten funds, and 31% manage more than ten funds.

This paper presents a summary of the survey results and trends.

[1] Larger fund groups are funds that, together with other investment companies in the same "group of related investment companies," have net assets of $1 billion or more as of the end of the most recent fiscal year. Smaller fund groups are funds that, together with other investment companies in the same "group of related investment companies," have net assets of less than $1 billion as of the end of the most recent fiscal year.

II. RESULTS

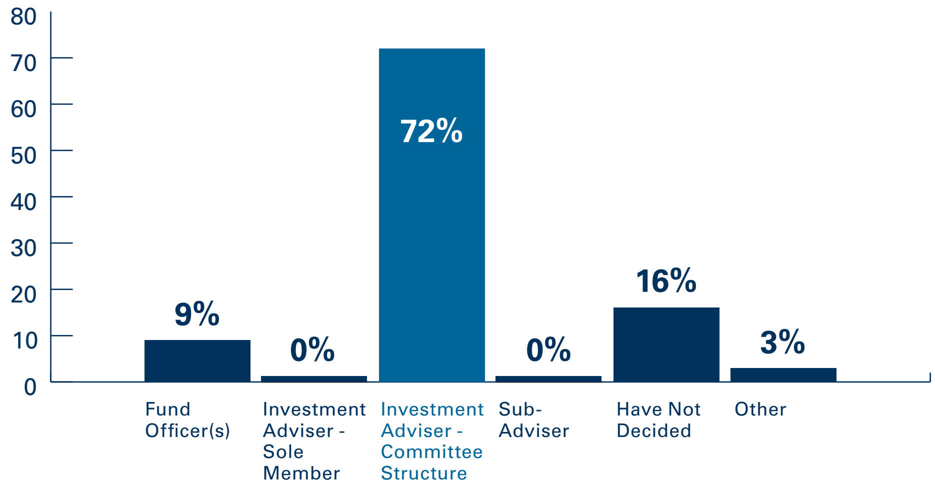
A. Program Administrator

The liquidity program rule requires a fund's board of directors to appoint an administrator responsible for overseeing the fund's liquidity program and for providing the board a written report on the adequacy of the liquidity program, including the highly liquid investment minimum ("HLIM") and the effectiveness of the program's implementation.

The Commission has clarified that the program administrator can be the fund's adviser (or sub-adviser if appropriate), officer, or officers. The role of program administrator can be fulfilled by an individual or a committee but cannot solely be fulfilled by a portfolio manager. Investment advisers and sub-advisers may be delegated responsibilities under the liquidity program with appropriate oversight by the program administrator.

Twenty-three fund complexes (**72%**) indicated that the investment adviser, through a committee structure, will be designated as the program administrator. Notably, none of the fund complexes are delegating program administrator responsibility to a single individual at the adviser or to sub-advisers. A full breakdown of the administrator designation responses appears below.

Fund Complex Program Administrator

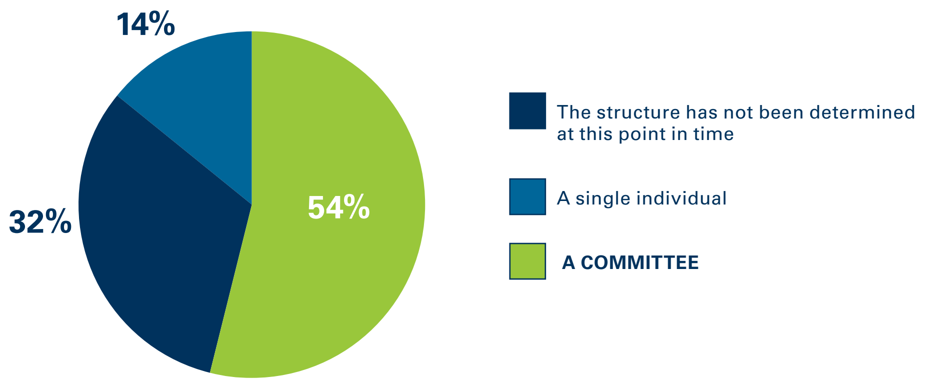


The two smaller fund groups differed on their delegated program administrator, with one tasking the investment adviser committee structure and the other tasking the fund officer(s). The one fund complex that indicated "other" noted that the delegation of the program administrator would vary by client. Presumably, this fund complex is a series trust that may allow each "family of funds" to designate its program administrator.

At the same time, advisers were asked, in cases where they have been delegated the role of program administrator, who would carry out the function. Thirty-seven advisers

(**82%**) indicated that they were delegated the role of program administrator. Of these 37 advisers, 20 (**54%**) indicated that they will implement a committee structure.

Adviser-Delegated Program Administrator

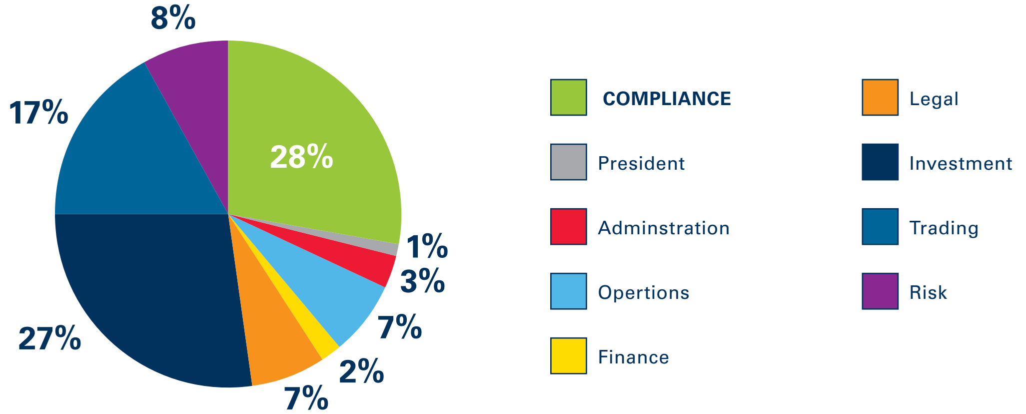


Of the five advisers that identified a single individual to serve as program administrator,

- two advisers that manage between five and ten funds have appointed the funds' president,
- one adviser that manages between one and five funds has appointed the chief compliance officer, and
- two advisers that manage more than ten funds have appointed the chief financial officer or the chief investment risk officer.

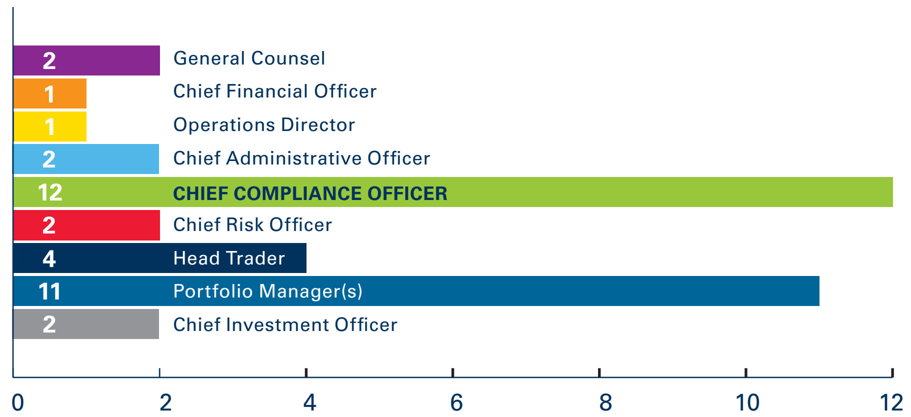
For the 20 advisers that identified a committee to serve as program administrator, the identified committee makeup varied by respondent. However, compliance, investment, and trading personnel were most commonly identified as committee members. Further responses on this issue are shown in the graphic below.

Committee Membership



The representation above oversimplifies committee membership because many advisers were exact in identifying the titles of professionals serving on the committee. The graphic that follows presents a more detailed look by listing these individuals by their position. *(Note: The numbers shown on the next page may not fully add to the percentages in the graphic above.)*

Committee Members by Title



In addition, several advisers noted that the liquidity program administrator committee will comprise the same individuals as the current valuation or risk committees. Regarding portfolio managers, one adviser noted that these persons will support the liquidity program administrator committee, while another noted that portfolio managers will attend the committee meetings but not have a vote. One adviser explicitly stated that portfolio managers will be excluded from committee membership.

B. Program Adoption

When the liquidity program rule was first adopted, larger fund groups were given until December 1, 2018, to adopt a liquidity program. Smaller fund groups were afforded an additional six months with a deadline of June 1, 2019. In early 2018, the Commission voted to delay the compliance deadline

(i) for funds to implement the liquidity program rule's liquidity classification requirement,

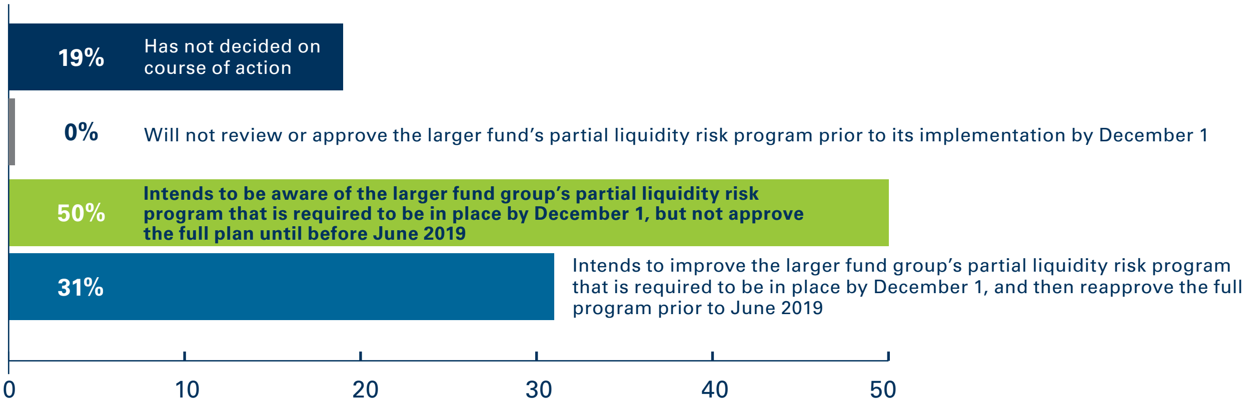
(ii) for funds to implement an HLIM, and

(iii) for a fund's board of directors to approve the fund's liquidity program.

This action raises the question of how fund boards should precede, given that the Commission only delayed portions of the rule and is allowing boards to defer approval of liquidity programs until the end of the six-month extension.

Half (**16**) of the fund complexes indicated that the fund board intends to be aware of the funds' partial liquidity program, which must be in place by this December, but not approve the full program until prior to June 2019. One can infer that the board does not want to be put into a position of approving an unfinished program and is possibly looking to benefit from the fund and the adviser having more time to further refine the fund's final liquidity program. The complete breakdown of responses regarding board program adoption timeline is shown on the next page.

Board Adoption of Program



Interestingly, five of the six fund complexes that have not decided on a course of action at this time are larger fund groups. Given that larger fund groups need to establish a general liquidity program by December 1, a decision by the board on how it wants to approach initial involvement and possible approval would certainly factor into a fund's timeline for development, presentation, and refinement. Boards may be moving at different speeds depending on the complexity of their fund complex (e.g., manager-of-managers, multi-manager sleeve funds, non-equity funds).

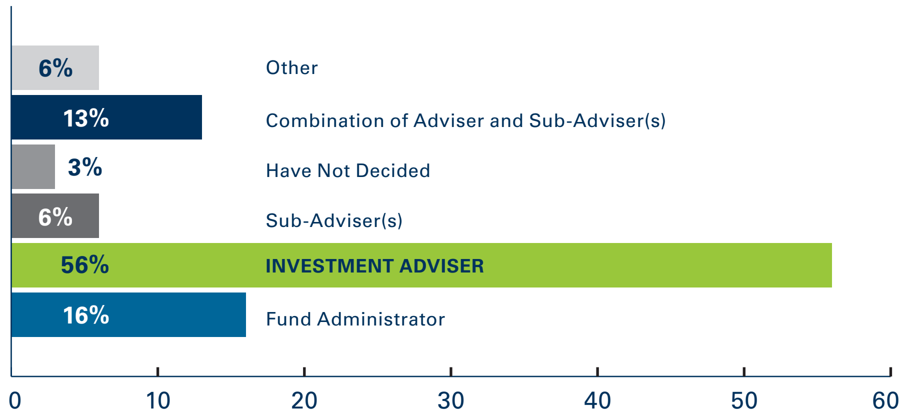
C. Liquidity Classification

One of the majority underpinnings of the liquidity program rule is the requirement to classify a fund's portfolio holdings into four liquidity classifications: highly liquid, moderately liquid, less liquid, and illiquid. Each fund must determine the classifications using information obtained after reasonable inquiry and taking into account market, trading, and investment-specific considerations. Such classifications must occur at least monthly but could occur more often, as the Commission staff discusses in its liquidity program rule frequently asked questions.

i. Fund Delegation of Classification Responsibility

Much conversation has occurred regarding who will be responsible for classifying a fund's portfolio holdings' liquidity. More than half (**18, or 56%**) of the fund complexes indicated that the investment adviser will be charged with the classification requirement. The complete breakdown of responses on this issue is shown on the next page.

Liquidity Classification Delegation



For the four fund complexes that will delegate to a combination of the funds' adviser and sub-adviser, a situation could presumably occur in which a sub-adviser has expertise in an asset class (e.g., distressed debt) that the main adviser does not. This situation may also involve an arrangement where the adviser maintains the majority of the classification responsibility but expects a sub-adviser to provide insight into the process and classification results (i.e., this may be similar to instances in which a sub-adviser takes part in the fair valuation of a security).

Five fund complexes originally provided an "Other" response to the delegation question. In two instances, the original responses were re-categorized under the "Investment Adviser" category and in one instance under the "Fund Administrator" category. In all three cases, the respondent chose the "Other" category to elaborate more on the delegation. In an additional instance, a fund complex indicated that the responsibility would be assigned to the fund administrator and the investment adviser. One other fund complex noted that it "may work with a vendor."

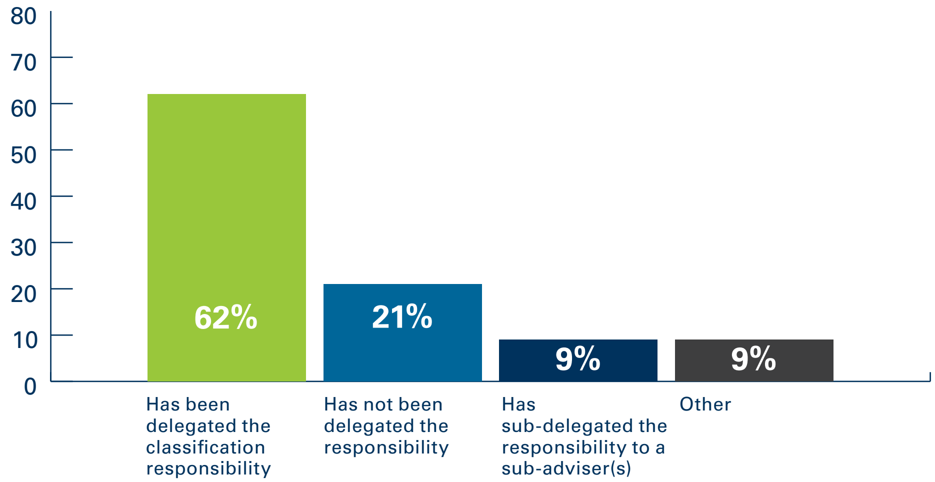
For the two smaller fund groups, one will delegate the responsibility to the investment adviser and the other to the adviser and a sub-adviser or sub-advisers.

ii. Adviser Delegation of Classification Responsibility

Eleven advisers (**24%**) have not been informed of whether they will be responsible for liquidity classification. This is a much higher figure than the 3% of fund complexes that indicated they have not yet determined who is best suited to perform the liquidity classifications. It is not clear, however, whether these 11 advisers are main fund advisers or sub-advisers or whether a disconnect has occurred between the determination to delegate responsibility and the act of informing the delegate of its responsibility. As indicated in the graphic below, three advisers (**9%**) will delegate such responsibility to a sub-adviser or sub-advisers.

Of the 34 advisers that have been informed of their responsibilities, 21 (**62%**) have been delegated the classification responsibility. A complete breakdown of the delegation responses is shown on the next page.

Adviser Delegated Classification

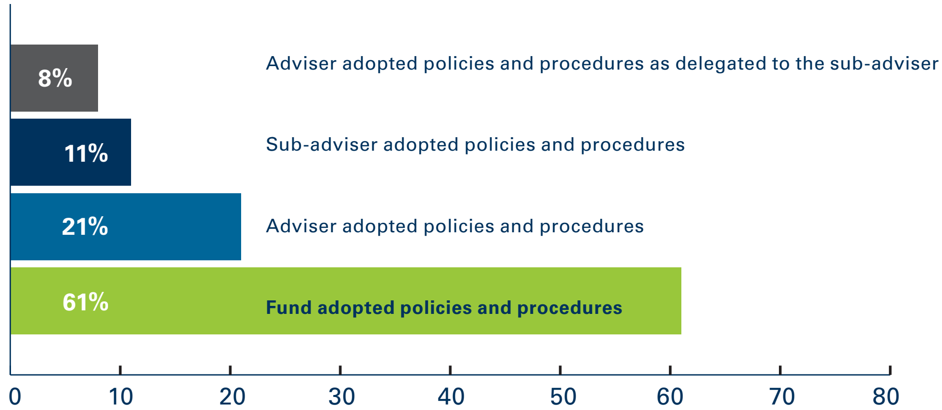


The "Other" category reflects an interesting accumulation of responses. One adviser indicated that it manages In-Kind ETFs and thus will be exempt from having to classify the liquidity of portfolio investments. Two other advisers answered as main fund adviser and sub-adviser, noting that, when acting as a fund's main adviser, they will be delegated the classification responsibility. When acting as sub-adviser, however, one adviser noted that it has not been delegated classification responsibility and the other that it has not been informed of whether it will have any classification responsibilities.

iii. Policies and Procedures Delegation

When faced with liquidity classification delegation, advisers and, in some cases, sub-advisers need to determine which set of policies they will follow to carry out the delegated duties. Twenty-three advisers (**61%**) indicated they will follow fund-adopted policies and procedures when performing the delegated liquidity classification function rather than create their own distinct policies. A complete breakdown of the liquidity classification policies and procedure responses appears below.

Liquidity Classification Policies and Procedures

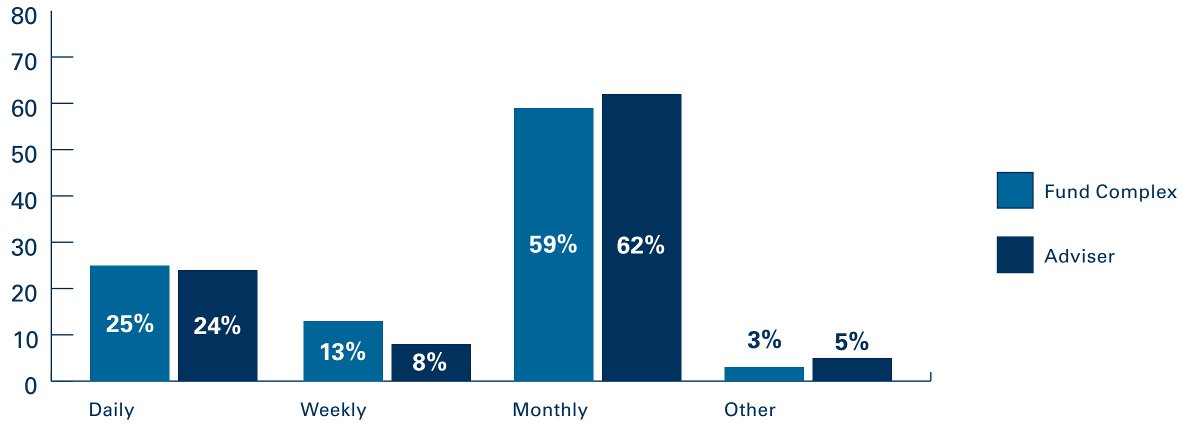


iv. Frequency of Classification

A fund must classify its portfolio investments at least monthly but may need to do so more frequently "if changes in relevant market, trading, and investment-specific considerations are reasonably expected to materially affect one or more of its investments' characteristics." This "intra-month re-evaluation" as the Commission staff puts it in its frequently asked questions on the rule, would be governed by a fund's policies and procedures, which would identify "objectively determinable events" that a fund reasonably expects would materially affect an investment's classification.

As presented below, over half the fund complexes and advisers delegated classification responsibilities[2] in the survey intend on classifying the liquidity of portfolio holdings on a monthly basis.

Frequency of Classification



Two fund complexes and two advisers added further context to their use of monthly classifications, generally noting that the formal classification would occur monthly but informal monitoring would occur daily and that, as consistent with the rule, the entity would reclassify intra-month if a material effect on the liquidity classification occurred.

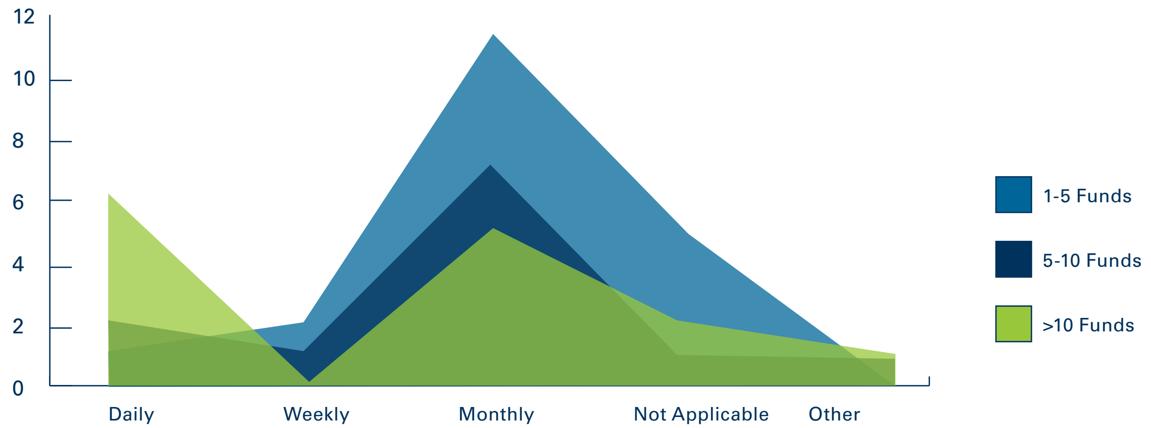
One fund complex and two advisers indicated that they undecided regarding their approach to classification frequency.

Both smaller fund groups indicated that they would classify their portfolio holdings' liquidity monthly.

When looking further into the advisers' responses on the frequency of classification, the trends shown below presented themselves.

[2] Eight advisers indicated that they were not delegated classification responsibilities.

Frequency by Number of Funds Managed



Of the nine advisers that indicated they would undertake daily liquidity classifications, we found the following regarding their approach.

- Three intend to build in-house capabilities. Of these, two manage between five and ten fun and one manages more than ten funds.
- Three intend to hire a vendor similar to the fund administrator's vendor, while another two intend to hire a vendor different from that of the fund administrator. These five managers all manage more than ten funds.
- Only one adviser is sub-delegating classification responsibilities to a sub-adviser. This adviser manages more than ten funds.

Of the three advisers performing weekly classifications, two advisers are hiring a vendor similar to the fund administrator's vendor.

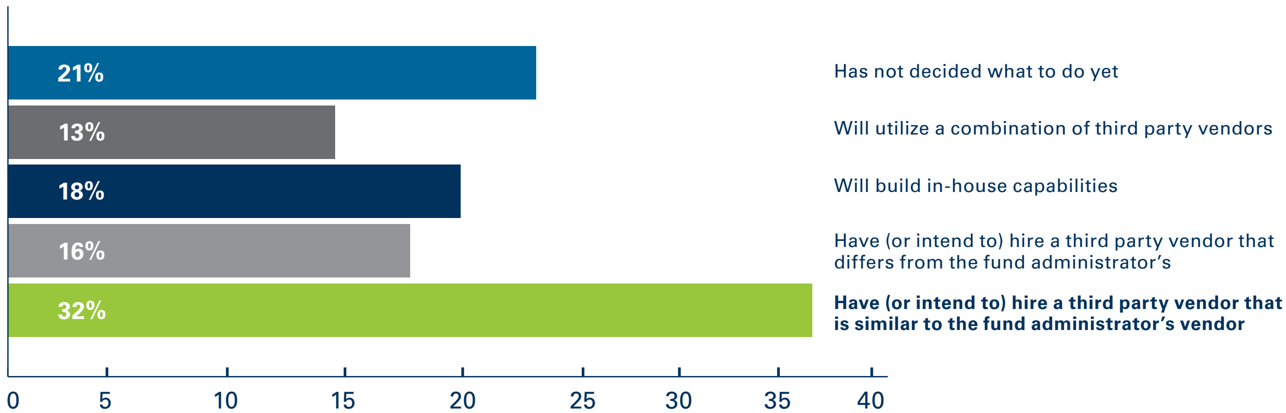
The higher frequency of classification would presumably add comfort for advisers in monitoring compliance with a fund's determined HLIM and the 15% limitation on holding illiquid assets. Given the larger number of funds managed by the responding advisers, such advisers may also be larger in terms of assets under management and be able to process data sent weekly and daily. In contrast, the one adviser that has delegated a daily classification requirement to the sub-adviser may, depending on the sub-adviser's size and sophistication, be putting an extreme burden on the firm and its personnel.

v. Method of Classifying Liquidity

The classification of a fund's portfolio holdings is considered by many to be perhaps one of the hardest elements of the liquidity program rule and, possibly, one of the most expensive. Given the new challenge of assessing the liquidity of all portfolio holdings and dividing them into four distinct buckets compared to the more general "illiquid or not" assessment now undertaken, fund complexes and advisers are expected to use technology to assist in their liquidity classifications.

Thirty-eight advisers (**84%**) reported that they have been tasked with classifying the liquidity of portfolio investments. Of these, only 18 (**18%**) intend to build an in-house technology solution. The complete breakdown of classification methodologies appears below.

Classification Methodology



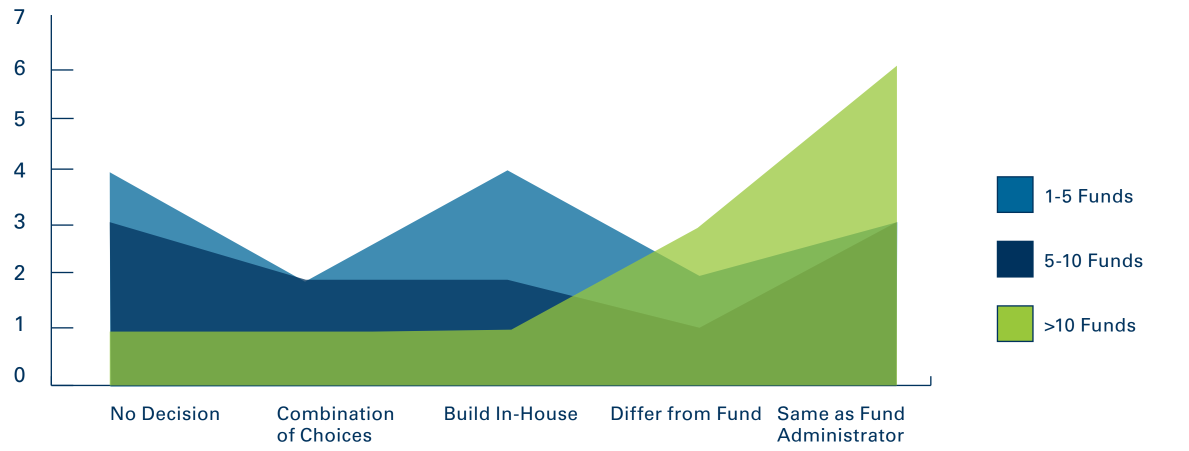
To give context to the decisions noted above, it appears that those advisers managing more than ten funds will use a third-party vendor similar to the fund administrator's vendor. Conversely, advisers managing between one and five funds intend to build an in-house technology solution. These decisions may imply an economy of scale in hiring a vendor versus building in-house capability, or they could reflect the asset class the adviser specializes in, with a less liquid or more esoteric asset class requiring more in-house expertise than what is available through a vendor.

Fund complexes and advisers that plan to use third-party vendors for liquidity classification purposes will need to perform initial and annual due diligence to understand the vendor, the product, and the underlying classification methodologies. The Commission noted in the release adopting the liquidity program rule that a fund should consider having the individual or individuals assigned to administer the liquidity program also undertake the due diligence of the third party and any data received from it.

For those advisers looking to engage a third-party vendor that differs from the fund administrator's vendor, the adviser will need to consider how using such vendors may lead to different liquidity classifications and how such differences will be addressed regarding fund compliance and fund regulatory reporting. These considerations might be addressed in the overall fund liquidity program or policies and procedures.

A complete breakdown of the classification methodologies according to the number of funds managed appears on the next page.

Methodology by Number of Funds Managed

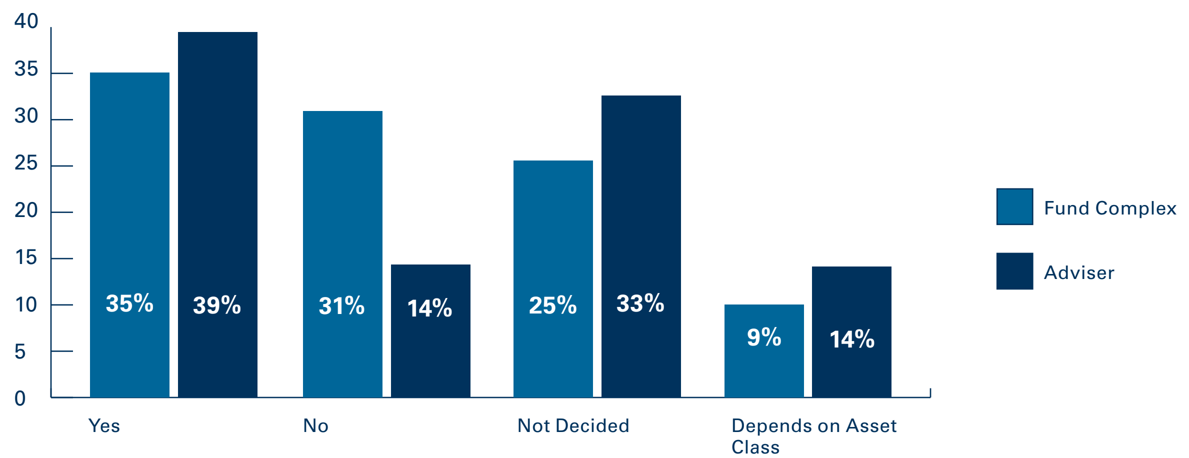


D. Asset Classification

A fund may classify portfolio investments based on asset class as long as it or its adviser or sub-adviser, after reasonable inquiry, has no information about any market, trading, or investment-specific considerations that would be reasonably expected to significantly affect an investment's liquidity characteristics in a manner that would change its classification.

Whereas the respondents demonstrated general agreement on the frequency of the liquidity classification, they appear to part ways on whether they intend to use asset class classification, as the graphic below illustrates. The survey did not ask respondents to provide the types of assets classes to support each response, including the "Depends on Asset Class" category.

Classification by Asset Class



Three larger fund groups and five advisers noted that their decision to classify by asset classes depended on the actual asset class under review. Additional commentary from the respondents is presented below.

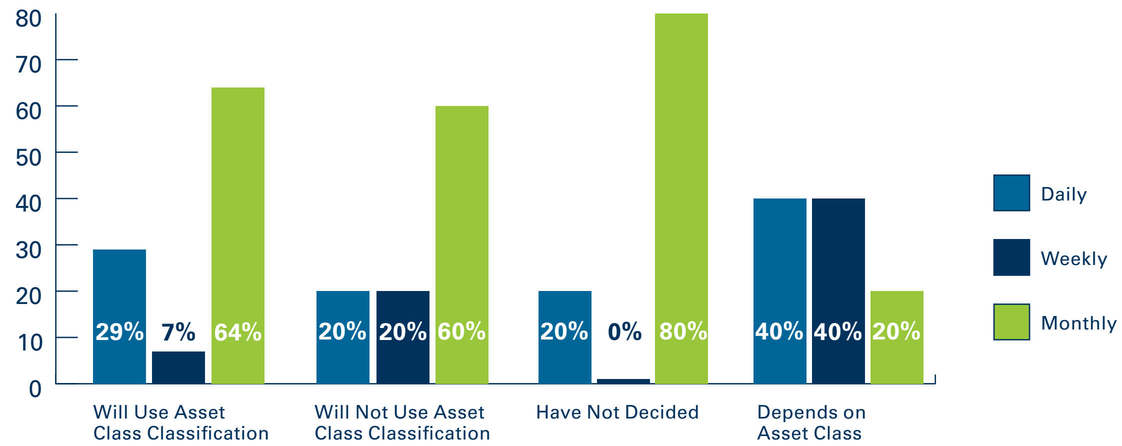
Fund Complex	Adviser
Large equities and futures will be classified by asset class, while all others will be classified by individual security.	Under certain situations (i.e., no vendor coverage), may revert to asset class (e.g., bank loans).
U.S. Treasuries (presumably meaning that such securities backed by the U.S. government would be classified by asset class)	For equity investments, each name will be assessed on its own; for other asset classes, such as index options, may classify on the asset class level.
Assets with available market trading data will be classified at the security level; for assets with no market data, they will make asset class level assumptions.	May use asset classes in a limited capacity where our tool cannot classify.
	Will set separate parameters for the analysis by asset class, but the results of the analysis will be made on each security individually.

Two of the eight undecided fund complexes were the smaller fund groups.

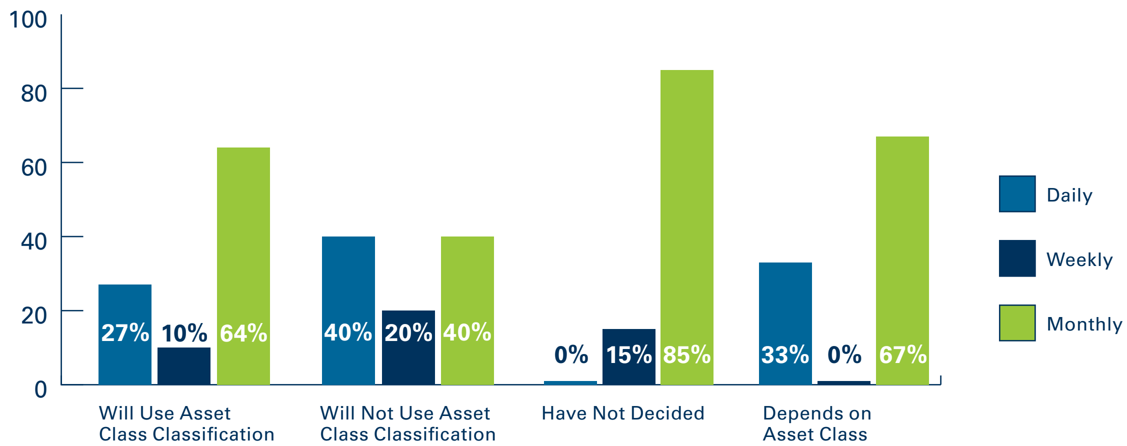
For those fund complexes that decided to use asset class classification, nearly two-thirds (**7, or 64%)** will apply this practice when classifying liquidity on a monthly basis. This association also holds true for advisers that indicated they have been delegated liquidity classification responsibilities (**9, or 64%**). Notably, however, a fair number of fund complexes (**6, or 85%**) and advisers (**8, or 80%**) that had not decided on the use of asset class classification at the time of the survey also intend to classify liquidity monthly.

Interestingly, advisers and fund complexes intend to use asset class classification more often for a daily over weekly classification frequency. One could believe that, as the frequency of the classification increased, the level of detail and accuracy necessary to classify securities into the proper liquidity bucket would increase as well, thus negating the need for asset class classification. Alternatively, some advisers and fund complexes may use the asset class classification to get a broader, higher-level view of a fund's liquidity profile generally and for monitoring the fund's proximity to its HLIM. This could be followed by a more detailed review of individual securities each month or on occasions when the fund comes within a tolerance of the HLIM.

Asset Class Classification vs. Frequency - Adviser



Asset Class Classification vs. Frequency - Fund Complex



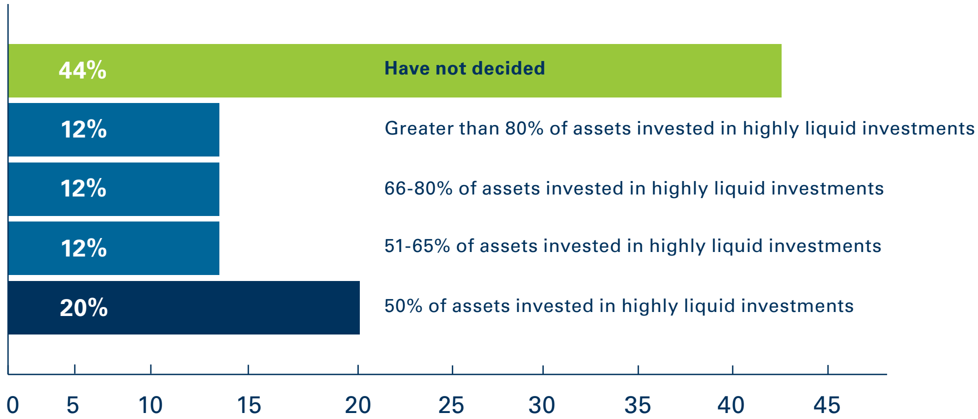
E. Primarily Highly Liquid Investments

A fund must determine its HLIM, that is, the minimum amount of its net assets that it invests in highly liquid investments that are assets. In determining its HLIM, a fund is required to consider factors, as applicable, similar to those considered in assessing liquidity risk. Funds whose portfolio assets primarily consist of highly liquid investments, as well as In-Kind ETFs, are not subject to the HLIM requirement. In the Commission's view, "primarily" would mean at least 50% of assets are in highly liquid investments.[3]

Seven fund complexes (**22%**) indicated that they are not looking to rely on this exemption from establishing an HLIM. Of the remaining 25 fund complexes, nearly half (**11 or 44%**) have not decided yet on how to define "primarily," while five (**20%**) are leaning toward using the Commission's definition of "primarily." A breakdown of the responses regarding this issue is shown on the next page.

[3] See *Investment Company Liquidity Risk Management Programs*, IC-32315 (October 13, 2016) at footnote 726.

'Primarily' Highly Liquid Investments



It is not surprising that 44% of respondents have not decided on a course of action regarding the HLIM, given, in part, the delay in the deadline for establishing an HLIM until June 1, 2019, for larger fund groups. At the same time, the HLIM is determined based on factors similar to those considered when assessing a fund's liquidity risk, and this risk may not have been determined yet. The interesting secondary question here is this: Does the determination of "primarily" depend on fund type, or is this a number that is used throughout the fund complex? One would suppose the answer would be fund type given the assessment of each fund's liquidity risk and amount of highly liquid assets.

Of the smaller fund groups, one was still undecided regarding the HLIM definition, while the second intends to define "primarily" as 50% of assets investments invested in highly liquid investments.

F. In-Kind ETF

The liquidity program rule defines an In-Kind ETF as an exchange-traded fund ("ETF") that meets redemptions through in-kind transfers of securities, positions, and assets other than a de minimis amount of cash and that publishes its portfolio daily. An ETF that meets this definition would be exempt from having to classify the liquidity of its portfolio holdings and from having to establish an HLIM. In the first part of 2018, the Commission staff provided responses to seven frequently asked questions addressing the treatment of ETFs.

Two-thirds of fund complexes (**21, or 66%**), including the smaller fund groups, indicated they did not include ETFs. Of the remaining 11 fund complexes, five indicated that they intend to analyze the applicability of the In-Kind ETF exemption on an ETF-by-ETF basis.

While qualifying as an In-Kind ETF may be a favorable option given the exemption from classifying portfolio holding liquidity and the determination of an HLIM, fund complexes may find compliance with the exemption requirements difficult or even not worth the effort. There are additional compliance concerns regarding de minimis cash amounts and the actions needed should an ETF lose its ability to rely on the In-Kind ETF exemption. Furthermore, fund complexes may come to decide that, if they have to apply the liquidity program rule requirements to other funds, what is another fund, or in this case an ETF, added to that mix?

III. CONCLUSION

As the liquidity rule program compliance dates approach, uncertainty still remains in the industry regarding how best to navigate its many elements. This survey focused on providing insight into how advisers and fund complexes are managing this puzzle. The results show good strides toward compliance with the rule but that, at the same time, fund complexes/boards, advisers, and sub-advisers continue to contemplate how they will comply fully with the rule. Our survey makes it clear that no one-size-fits-all approach exists for attaining compliance. That said, we hope that sharing our results will assist you as you think, plan, and eventually adopt a liquidity program.

About ACA Compliance Group

ACA Compliance Group ("ACA") is a leading provider of risk management and technology solutions that focus on regulatory compliance, performance, financial crime, and cybersecurity. We partner with our clients to help them mitigate the regulatory, operational, and reputational risks inherent in their business functions. Our clients include leading investment advisers, private fund managers, commodity trading advisors, investment companies, broker-dealers, and domestic and international banks.

Our products include standard and customized compliance packages; cybersecurity, AML, and risk assessments; GIPS® verifications and other performance services; and a wide variety of business advisory and technology solutions for financial services firms.

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For more information, contact **Maureen Colligan** at mcolligan@acacompliancegroup.com or at (617) 589-0904.