

Rule 18f-4: Transition timelines

At U.S. Bank Global Fund Services, we're preparing to support clients as they make this significant change to the management of risks related to derivatives transactions. Looking over our own plans, we thought it might be helpful to share some steps we see on the horizon.

Funds relying on the Rule 18f-4's (the "Rule") limited derivatives user exception will have a different series of steps from funds with derivatives exposure that exceeds the 10% of net assets threshold. We've created two timeline views to address both sets of users.

Limited derivatives users transition timeline

Spring 2021

- Determine whether funds will qualify as "Limited Derivatives Users";
- Determine how currency hedges, reverse repurchase agreements or similar financing transactions and unfunded commitments will be treated (either as Borrowing or as Derivatives);
- Determine impact of securities lending transactions (not considered "similar financing transaction" unless a fund invests the cash collateral in securities other than cash or cash equivalents);
- If utilizing Sub-Advisers, begin discussions with Sub-Advisers on their involvement derivatives oversight;
- If funds are close to the 10% threshold, determine whether to implement a requirement to stay under 10% in its registration statement; and
- Educate Board on initial plans for compliance with the Rule.

Fall 2021

- Determine impact on or assistance from service providers (e.g. Sub-Advisers, Fund Administrator, Auditor, Fund Counsel, Compliance Consultant, etc.);
- Determine who will be responsible for monitoring compliance with the Rule (e.g., Compliance, Committee, Risk, etc.);
- Determine how to monitor for compliance with the Rule (e.g. pre/post-trade compliance system, portfolio compliance checklist, manually, etc.);
- Draft required policies and procedures governing derivatives use;
- Determine impact to existing compliance policies and procedures (e.g., Liquidity Risk Management Program, leverage/segregation policies, record retention, etc.); and
- Update compliance policies and procedures as required.

Spring 2022

- Request Board approval for derivatives policies and procedures, along with any other impacted compliance policies and procedures;
- Discuss with Board their preference for reporting on compliance with the Rule;
- Test monitoring plan, including notification process for breach of 10% threshold;
- Review registration statement and marketing materials to ensure consistency of disclosures regarding derivatives use; and

- Incorporate testing of compliance with the Rule into 38a-1 compliance program.

August 19, 2022 (and thereafter)

- Implement policies and procedures; and
- Perform ongoing monitoring and reporting.

Derivatives Rule 18f-4 transition timeline

Spring 2021

- Determine whether funds are “Limited Derivatives Users”;
- Determine how currency hedges, reverse repurchase agreements or similar financing transactions and unfunded commitments will be treated (Borrowing or Derivatives);
- Determine impact of securities lending transactions (not considered “similar financing transaction” unless a fund invests the cash collateral in securities other than cash or cash equivalents);
- Educate Board on initial plans for compliance with the Rule;
- Initial discussions on who will serve as Derivatives Risk Manager (DRM);
- Initial discussions on sourcing of VaR calculation, including backtesting, and stress testing (i.e. internal or 3rd party provider); and
- If utilizing Sub-Advisers, begin discussions with Sub-Advisers on their involvement with the Derivatives Risk Management Program (DRMP).

Fall 2021

- Determine impact on or assistance from service providers (e.g. Sub-Advisers, Fund Administrator, Auditor, Fund Counsel, Compliance Consultant, etc.);
- Determine who will serve as DRM;
- Determine VaR Test to utilize (Relative or Absolute), and if Relative Test will be utilized, determine designated reference portfolio;
- Initiate beta testing of processes built to determine appropriateness, including VaR test and risk metrics;
- Determine how to monitor for compliance with the Rule (e.g. pre/post-trade compliance system, portfolio compliance checklist, manually, etc.);
- Draft DRMP;
- Determine impact to and update existing compliance policies and procedures (e.g., Liquidity Risk Management Program, leverage/segregation policies, record retention, etc.);
- Continue discussions or select vendor to assist with VaR calculation, backtesting, and stress testing if not performing functions in-house; and
- Keep Board apprised of progress.

Spring 2022

- Request Board approval of DRM;
- Present DRMP to Board, along with any other impacted compliance policies and procedures;
- Determine the Board’s preference for reporting on compliance with the Rule;
- Continue beta testing of DRMP and make necessary adjustments to VaR modeling;
- Review registration statement and marketing materials to ensure consistency of disclosures regarding derivatives use; and
- Incorporate testing of compliance with the Rule into 38a-1 compliance program.

August 19, 2022 (and thereafter)

- Implement DRMP;
- Perform ongoing monitoring and reporting; and
- Present DRMP annual written report from DRM to the Board.

Preparations at U.S. Bank Global Fund Services

We are already at work on plans to assist with implementation of the Rule. An internal cross-functional working group is reviewing the conditions of the Rule and is working to determine what service enhancements U.S. Bank Global Fund Services may offer to help clients meet the requirements of the Rule.

Here are some areas in which we will be available to assist:

- Updating of compliance testing to account for the Rule's conditions;
- Researching vendors to provide data to assist in the monitoring of compliance with the Rule;
- Drafting of reporting and disclosures required on Forms N-PORT, N-RN, and N-CEN;
- Recordkeeping required under the Rule, as applicable under our servicing agreements; and
- For funds operating in a multiple series trust structure; coordination and preparation of materials for review and approval by the board of trustees, including the adoption of a trust-level DRMP.

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