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SEC seeks to modernise investment reporting and disclosures

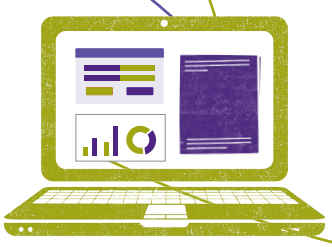
In a unanimous vote May 20, 2015, the Securities and Exchange Commission (SEC) proposed reporting and disclosure changes for investment companies and registered investment advisers. Primary goals of the proposals are to modernise and enhance the disclosures while improving the SEC's use of technology in collecting, monitoring and analysing risks.

The SEC specifically hopes to enhance data collection related to derivatives, securities lending activities, liquidity, and pricing of portfolio instruments for registered investment companies, not including money market funds. Further, the proposed changes would expand the SEC's ability to identify and monitor risks of registered investment companies and registered investment advisers. The agency feels the new measures are necessary due to the growth of new and more complex investment products and strategies.

"These recommendations will vastly improve the type and format of the information that funds provide to the (SEC) and to investors," said SEC Chair Mary Jo White. "Investors will have better quality and greater access to information about their fund investments and investment advisers, and the SEC will have more and better information to monitor risks in the asset management industry.[1]"

New proposals at a glance

- **new forms**: mutual funds, Exchange-Traded Funds (ETFs) and other registered investment companies would be required to file two new forms designed to gather structured data, allowing for better public and private data analysis:
  - **Form N-PORT**: a monthly portfolio reporting form; and
  - **Form N-CEN**: an annual reporting form that would gather census-type information.
- **regulation S-X (enhanced financial statement disclosures)**: enhanced, standardised financial statement disclosures would be required;
- **Form ADV amendments**: these amendments would require investment advisers to provide additional risk information;
- **website disclosure**: a proposed new rule of the Investment Company Act (i.e. proposed Investment Company Act Rule 30e-3) would permit mutual funds and other investment companies to provide shareholder reports via a website; and
- **investment adviser-related amendments**: Investment Advisers Act of 1940 (Investment Advisers Act) Rule 204-2 amendments would require advisers to maintain records of performance calculations and performance communications.



[1] SEC. "SEC Proposes Rules to Modernise and Enhance Information Reported by Investment Companies and Investment Advisers" (press release), SEC.gov, May 20, 2015. See www.sec.gov for details.

Key elements of the proposals are summarised below, and the full proposals are available here[2] and here.[3]

Form N-PORT

This monthly portfolio reporting form would require registered funds, not including money market funds or Small Business Investment Companies (SBICs) to provide monthly portfolio-wide and position-level holdings data electronically to the SEC within 30 days of month-end. Reporting on investments would include:

- portfolio pricing data;
- repurchase agreements, securities lending activities and counterparty exposures;
- derivatives contract terms (e.g., counterparties, reference instruments);
- the fund's portfolio (including, for fixed-income funds, measurements of duration); and
- discrete portfolio-level and position-level risk measures to better understand fund exposure to changes in market conditions

Information available to the public would include reports for the last month of each fund's fiscal quarter. Although a fund would file Form N-PORT with the SEC monthly, only information contained on Form N-PORT for the past month of the fund's fiscal quarter would be made publicly available, on a 60-day delay. In addition, the SEC also proposes rescinding Form N-Q, where funds currently report certain portfolio holdings for the first and third fiscal quarters. The SEC also proposes to lengthen the look-back for Sarbanes-Oxley certifications on Form N-CSR to six months to cover the gap in certification coverage that would otherwise occur once Form N-Q is rescinded.

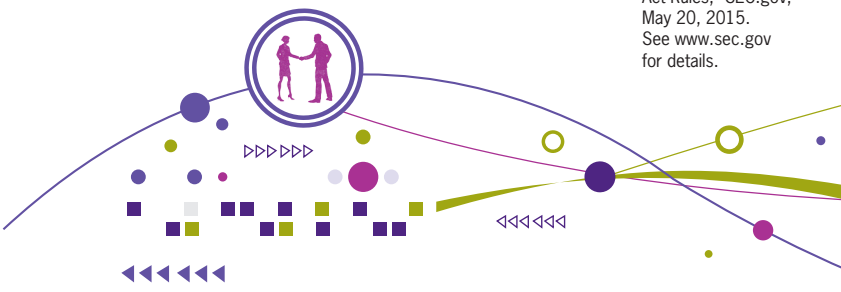
The expected compliance dates for the new Form N-PORT requirements are 18 months after the effective date of the new rules for funds with net assets of $1 billion or more, and 30 months for smaller funds.

Form N-CEN

This annual reporting form would require registered funds to report census-type information to the SEC. The new forms must be filed in the XML format. It would replace the form currently used to report fund census information (Form N-SAR).
The new form would streamline and update reported information; collect more background information about the registrant, officers and directors; report whether the fund relied on exemptive orders under the Investment Company Act of 1940 or the Securities Act of 1933; provide information regarding the fund's securities lending activities and whether the fund obtained financial support from affiliates; disclose NAV errors; report whether the fund had any expense waivers during the year; and disclose brokerage and research payments, among other items.
Reports would be filed annually within 60 days of the end of the fund's fiscal year, rather than semiannually as is currently required by Form N-SAR for most funds.

Form N-CEN would also require, like Form N-SAR, that management companies, other than SBICs, file a copy of their auditor's report on internal control as an attachment. However, Form N-CEN would also include a new question that asks whether the report on internal control found any material weaknesses.
Form N-CEN would also contain a new requirement that the fund disclose whether the certifying accountant issued an opinion other than an unqualified opinion with respect to its audit of the fund's financial statements. These questions will gather information on potential accounting issues identified by a fund's accountant.

The expected compliance date for the new Form N-CEN requirements is 18 months after the rules' effective date.



[2] SEC. Releases No. 33-9776; 34-75002; IC-31610, "Investment Company Reporting Modernisation," SEC.gov, May 20, 2015. See www.sec.gov for details.

[3] SEC. Release No. IA-4091, "Amendments to Form ADV and Investment Advisers Act Rules," SEC.gov, May 20, 2015. See www.sec.gov for details.

Regulation S-X: enhanced financial statement disclosures

Enhanced and standardised disclosures in financial statements would be required in fund registration statements and shareholder reports. Examples of the required disclosures would include:

- **derivatives**: new standardised disclosure for fund holdings in open futures contracts, open forward foreign currency contracts and open swap contracts would be required. Additional information would also be required for holdings in written and purchased options. These derivative disclosures would be required to be displayed clearly in the financial statements, rather than in the notes;
- **investments in securities of unaffiliated issuers**: disclosures regarding funds' investments in securities of unaffiliated issuers, including categorisation by type of investment, industry and country or geographic region (funds are currently required to only disclose investments by industry, country or geographic region) would be required. For variable rate securities and other specified debt instruments, additional information about the relevant interest rate would be required, including the referenced rate and spread. Funds would also be required to identify each issue of illiquid securities, and to indicate whether any portion of the issue is a loan when the securities are held in connection with open put or call option contracts and loans for short sales;
- **securities lending**: additional disclosures on securities lending activities would be required in the notes to fund financial statements, including the monthly average value of portfolio securities on loans, the income from and fees paid in connection with securities lending, and information on compensation arrangements with securities lending agents (including any revenue-sharing split); and
- **investments in and advances to affiliates**: additional disclosure regarding realised and unrealised gains or losses would be required.

The expected compliance date for the amendments to Regulation S-X is eight months after the effective date of the rules.

Rule 30e-3: website disclosure of shareholder reports in lieu of mailing

This new proposal would permit mutual funds and other registered investment companies to make shareholder reports and quarterly portfolio holdings for the past year available on their websites. Rules currently require that a fund must deliver shareholder reports by printing and mailing them, unless investors have requested electronic delivery. The SEC was careful to propose specific provisions to ensure that investors who want paper copies can continue to receive them by mail.

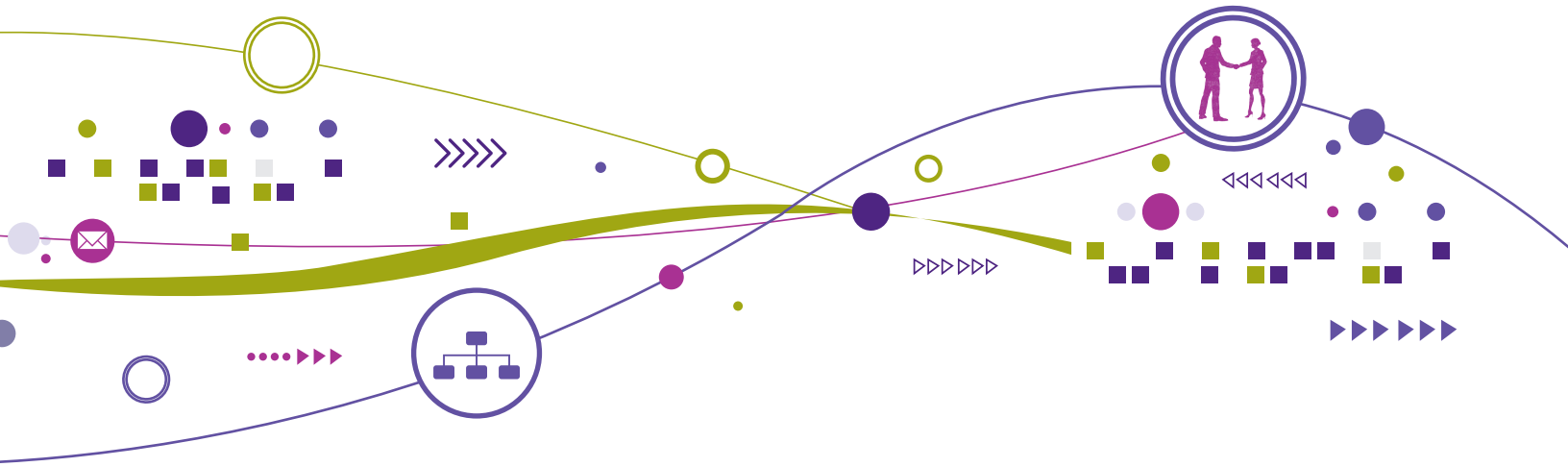
Funds will be able to rely on Rule 30e-3 immediately after the effective date.

Proposed investment adviser-related changes

The SEC also proposed several amendments to the investment adviser registration and reporting form (Form ADV), asking for additional information in hopes that it will help investors better understand the industry and advisers' risk profiles. New information requirements relate to:

- **separately managed accounts**: aggregate information would be required related to assets held and use of borrowings and derivatives in Separately Managed Accounts (SMAs). Advisers would be required to report information on Regulatory Assets Under Management (RAUM), the percentage of SMA RAUM invested in each of 10 asset classes and the percentage invested in derivatives. Advisers with at least $150 million of SMA RAUM would also be required to report information on the use of derivatives and borrowings. Advisers with at least $10 billion in SMA RAUM would be required to report the weighted-average gross notional value of derivatives in each of six different categories, and also would be required to report both midyear and year-end data on their annual Form ADV updates, whereas other advisers would provide only year-end data. In addition, all advisers would be required to identify each custodian that accounts for at least 10% of SMA RAUM, and the amount of SMA RAUM held at such custodian;
- **wrap fee programs**: advisers would be required to provide more detailed information about their participation in wrap fee programs, including the total amount of RAUM attributable to acting as sponsor and as portfolio manager;
- **umbrella registrations**: proposed form revisions would help provide a clearer and more efficient method for registering multiple private fund adviser entities under common control operating a single advisory business on a single Form ADV (umbrella registration). The proposed changes would introduce a new Schedule R to Part 1A of Form ADV to gather additional, more consistent data on groups of affiliated advisers;
- **number of clients and regulatory assets under management**: advisers would be required to report the number of the adviser's clients and the amount of RAUM attributable to each category of client as of the date the adviser determines its RAUM. The current Form ADV requires advisers to report only approximate ranges for the number and type of clients and amount of RAUM; and
- **other business information**: additional information about an adviser's advisory business would be required, including branch office operations and the use of social media.

The SEC also proposed amendments to Rule 204-2 under the Investment Advisers Act of 1940 that would require advisers to maintain records of the performance calculations that are distributed to anyone; currently, advisers are only required to maintain this information if it is distributed to ten or more people. The proposed amendments would also require advisers to maintain any communications related to performance or rate of return of accounts and securities recommendations. Other proposed amendments include changes to several other rules under the Investment Advisers Act that remove certain transition provisions that are no longer necessary.



Moving forward

These proposals indicate a clear indication of the SEC's expectations regarding enhanced quality and type of information reported and provided to investors by funds and advisers. More changes may be coming soon. Chair White said: "the staff is also developing recommendations to enhance the management and disclosure of liquidity risk by mutual funds and ETFs, and to update the liquidity standards for those investment vehicles. The staff is also reviewing options for specific requirements for the use of derivatives by funds, including measures to appropriately limit the leverage these instruments may create, in addition to enhanced risk management programs for such activities. And the staff is studying new requirements for stress testing by large investment advisers and large funds, as well as provisions for transition plans after a major disruption in an investment adviser's operations.[4]"

Comments were due by August 11, 2015. Firms should review the proposals and anticipate how they can make changes to their reporting, disclosure and other requirements to comply with the new measures when they are finalised.

How Grant Thornton can help

Grant Thornton professionals help dynamic investment advisers navigate the complexities of today's business landscape, ensuring that you can respond to ever-changing regulations and investor demands. For more information, visit our website or contact any of the listed professionals.

[4] White, Mary Jo. "Statement at Open Meeting: Modernising and Enhancing Investment Company and Investment Adviser Reporting," SEC.gov, May 20, 2015. See www.sec.gov for details.

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