

# Modernizing mutual fund reporting for today's environment



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**Investment company reporting modernization rule overview**

On 13 October 2016, the Securities and Exchange Commission (SEC) adopted new forms, rules, and amendments to modernize the current reporting and disclosure requirements of certain Registered Investment Companies (RICs). As the primary regulator of the investment management industry in the United States, the SEC continually identifies opportunities to address growth and complexity in the industry. In addition, as RICs grow, they will likely continue to innovate through the introduction of new products, fund types, and strategies.

While the industry has experienced unprecedented growth, the environment in which investment managers operate has also evolved.

The new requirements will improve enhance and standardize data reporting for mutual funds, ETFs and other RICs. Harnessing new available technology can help the SEC consume data from RICs in a more streamlined fashion, leading to enhanced aggregation and dissemination capabilities. The combination of a growing and complex industry and the cutting-edge technology designed to support it has led the SEC to adopt a rule that modernizes the current reporting regime by improving the quality of data provided to investors and helping regulators collect and analyze fund data more efficiently.

A number of specific drivers are behind the SEC's rule to increase reporting regulations. They include:

**New product structures**



New fund types and increased use of derivatives have added complexity and risks to the fund strategies.

**Technology advances**



New data tools allow the SEC to improve their collection and analytics of reported information.

**Data aggregation and analysis**



New reporting requirements enable investors and other market participants to simplify aggregation and analysis efforts.

**Reporting utility**



Existing reporting requirements have become outdated or of limited use to the SEC, market participants, and investors.

**Compliance examinations and inspections**



New reporting requirements enable the SEC to compare and analyze information across the industry to identify trends, outliers, and data inconsistencies.

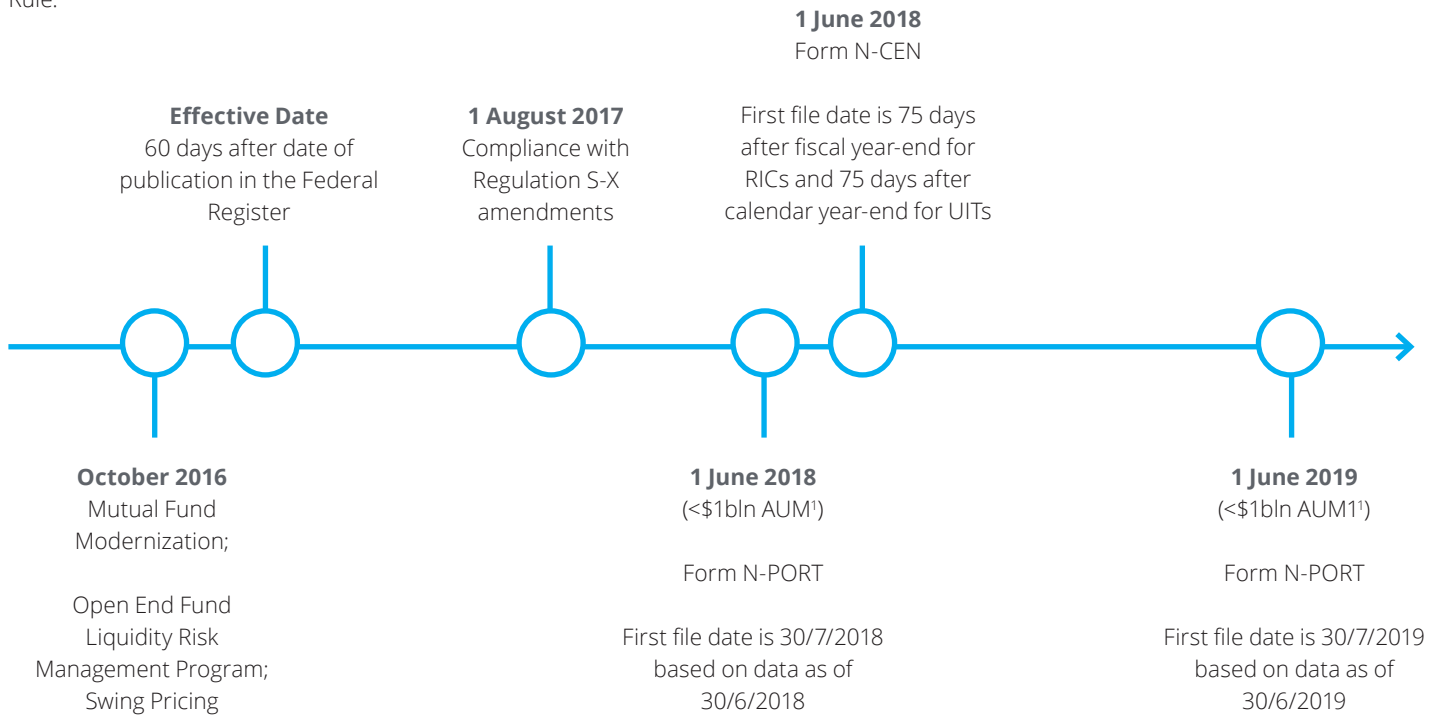
### Understanding the requirements and impacts

The table below provides a summary of the final SEC Modernization Rule:

Form, rule, or amendment	Requirements of form, rule, or amendment	Compliance dates
<p><b>New form</b> N-PORT (replaces Form N-Q, which will be rescinded as of 1 August 2019)</p>	<ul style="list-style-type: none"> <li>Affects RICs and Exchange Traded Funds (ETFs) organized as Unit Investment Trusts (UITs), except money market funds and Small Business Investment Companies (SBICs).</li> <li>Requires holdings information about each fund including type of derivative instrument within each asset category; repurchase agreements; controlled foreign corporations; legal entity identifier; securities lending activities; qualitative analysis, including strategy/risk; portfolio and position-level risk analytics; flow information; total returns for each of the preceding three months; and liquidity levels.</li> <li>Monthly filings no later than 30 days after each month-end, with every third month made publicly available 60 days after quarter end.</li> <li>Filed in Extensible Markup Language (XML).</li> <li>Portfolio information must be reported on the same basis</li> </ul>	<ul style="list-style-type: none"> <li>1 June 2018 compliance date; first file date is 30 July 2018, based on data as of 30 June 2018 (for RICs greater than or equal to US\$1B in AUM)</li> <li>1 June 2019 compliance date; first file date is 30 July 2019, based on data as of 30 June 2019 (for RICs less than US\$1B in AUM)</li> </ul>
<p><b>New form</b> N-CEN (replaces Form N-SAR, which will be rescinded as of 1 June 2018. Last filing on Form N-SAR will be for funds with semi-annual periods ending 31 March 2018.</p>	<ul style="list-style-type: none"> <li>Affects RICs, including money market funds.</li> <li>Requires census-type information, including background and classification of funds; investments in controlled foreign corporations; securities lending—collateral manager, lending agent, reporting period, and fund expenses waived, reduced, or recouped.</li> <li>Expanded to reflect new market developments, products, investment practices, and risks.</li> <li>Requires information about a fund's directors and chief compliance officer.</li> <li>Requires disclosure regarding reliance upon certain rules under the Act during the reporting period.</li> <li>Filed 75 days after fiscal year-end for RICs and 75 days after calendar year-end for UITs in XML format.</li> <li>Requires information on exemptive orders being relied upon.</li> </ul>	<ul style="list-style-type: none"> <li>1 June 2018 compliance date; first file date is 75 days after fiscal year-end for RICs and 75 days after calendar year-end for UITs</li> </ul>
<p><b>Amendment to Regulation S-X</b></p>	<ul style="list-style-type: none"> <li>New and standardized disclosures in fund financial statements and changes to disclosures of open futures, forward Foreign Exchange (FX), swap, and option contracts.</li> <li>Disclosures related to referenced rates and spreads, realized gains or losses, and total net increase or decrease in unrealized appreciation or depreciation for affiliated investments.</li> <li>Requires funds to indicate the interest or dividend rate and maturity date for certain debt instruments; identify securities held in connection with open put or call option contracts and loans for short sales; identify whether a derivative cannot be sold because of restrictions applicable to the investment.</li> </ul>	<ul style="list-style-type: none"> <li>1 August 2017</li> </ul>



The high-level timeline below depicts the major milestones required to achieve compliance with the SEC Modernization Rule.



<sup>1</sup> Defined as funds in the same group of related investment companies.

**Notes:**

- Amended certifications to Form N-CSR will follow the same compliance timelines as Form N-PORT. Timeline to comply with reporting a change of the independent public accountant on Form N-CSR will be consistent with the timeline for reporting other information on Form N-CEN. Thus, rescission of Form N-SAR will not be delayed beyond 1 June 2018. The last filing on Form N-SAR will be for funds with fiscal year ending 31 March 2018
- Replacement of form N-Q will be delayed until 1 August 2019 (with the last Form N-Q filing date of 31 May 2019) to allow funds sufficient time to satisfy Form N-Q's 60-day filing requirements for the final filing on Form N-Q for the reporting period preceding the first filing on Form N-PORT ➔



### Some key challenges

In order to satisfy the requirements of the SEC Modernization Rule, fund sponsors and service providers will be encouraged to invest in people, process, and technology to address certain challenges.

Challenges can be depicted along industry, infrastructure, and data dimensions:

### Industry challenges

#### *Data sourcing and aggregation*

- Information required for form N-PORT and N-CEN must be aggregated from multiple source systems
- Liquidity risk levels must be incorporated into Form N-PORT. (See new Rule 22e-4, the newly adopted rule requiring investment companies to implement liquidity risk management programs)
- Information will be sourced from financial intermediaries
- Third-party service providers and RICs will need to reevaluate data collection in order to meet the frequency of N-PORT filings

### *Implementation timeline*

Large fund complexes will need to do the following by 1 June 2018:

- Obtain project funding
- Determine the source of the required data
- Design and implement operating model changes
- Hire and train resources
- Perform functional testing as well as finalize procedures and controls

### *Compressed filing timeline*

N-PORT is required to be filed monthly within 30 days of month end instead of 60 days after the first and third quarter end for Form N-Q. The following may pose submission error risk in a compressed timeline:

- Manual data collection and report creation
- Manual review and signoff procedures
- Increased frequency of filings to the SEC

### *Complex calculations*

Form N-PORT will require complex calculations at a high frequency for portfolio risk metrics information and monthly returns attributable to derivatives.

Harnessing new available technology can help the SEC consume data from RICs in a more streamlined fashion, leading to enhanced aggregation and dissemination capabilities.



## Infrastructure challenges

### *Strategic*

Additional departments may need to provide input to complete form N-PORT and N-CEN including:

- Involving the appropriate resources required to interpret rule requirements
- Increasing oversight of service provider(s) that support data collection, processing, and form filing

### *Operational*

There is a potential need to:

- Enhance procedures for ongoing data collection, validation, and filing with the SEC
- Increase resources to accommodate compressed and increased filing timelines

### *Technology*

Developing appropriate data sourcing and aggregation processes will be integral to success, including solutions to perform:

- Calculations
- Derivatives disclosures
- Validation of data and store data elements [▶](#)





### Data challenges

#### *Transformation and Quality*

Newly required data points to be reported increases the burden placed on RICs and their service providers to ensure information is compliant with the issued taxonomy within the given timeframe. Some of the key internal data issues and requirements include:

- Specific investment level asset type, issuer type, and derivative classifications should be readily available on a monthly basis
- Detailed reference data for underlying investments may not be readily available in current processes
- RICs may face challenges in reporting to their service providers due to investment-level liquidity classifications
- Investment- and fund-level securities lending data requirements could call for reporting enhancements
- Interest Rate and Credit Spread Risk monitoring requirements could create added burden to reporting processes

- Investment details and collateral information requirements will represent a significant compliance reporting mandate

#### *Aggregation and Analysis of External Data*

The aggregation of internal and external data sources may present challenges to reporting quality and timeliness of filings:

- Identifying who is responsible for providing external source data
- Understanding what types of data to expect and the degree of format consistency
- Determining reliable data transmission options to help ensure timeliness and data integrity
- Understanding reporting timelines to allow time to handle aggregation issues that may arise
- Standardizing the point where external data is incorporated to avoid confusion about the accuracy of data being consumed
- Verifying consistency of multiple data sources to match RIC interpretations and SEC reporting guidelines





## Opportunities

Similar to other modernization initiatives driven by the SEC, opportunities will be available for firms that move efficiently to invest in people, process, and technology initiatives. The demands placed on RICs to comply with the SEC Modernization Rule will create opportunities to enhance existing reporting infrastructure. Opportunities include centralizing data, automating reporting and enhancing oversight.

### Centralized database



- The SEC Modernization Rule will present an opportunity for fund sponsors to utilize a centralized database pulling from various source systems to generate reports for shareholder and regulatory needs.
- Previously inaccessible data, such as counterparty information, may now be accessible from a central database.


### Data aggregation and analysis



- The SEC Modernization Rule will prompt third-party service providers to automate their reporting processes, thereby expanding automation capabilities across the reporting ecosystem.
- The new XML format will allow RICs to aggregate and analyze data more quickly and reduce the need for manual processing or data entry.

### Enhanced oversight



- RICs may use the new information to identify enhancement opportunities within internal compliance and audit programs and proactively address compliance issues.
- Compliance can leverage additional information to provide observations and recommendations that can improve regulatory reporting as well as operational and technological infrastructure. 



### Reporting and Controls Considerations

Standardizing processes and workflow around modernization reporting will be important to achieve efficient and accurate data preparation, review, and filing. Firms should consider assigning appropriate responsibilities within cross-functional areas including Accounting, Financial Reporting, Compliance, and Risk Management. Additionally, potential procedures should consider how to embed timeline-driven operational workflows into the reporting process, enabling the evaluation of how events will be completed within the process.

Incorporating proper reporting controls can help achieve data integrity, security, and accountability within the workflow process. Control environment considerations will involve securing the filing application and controlling the progress of filing and output.

Securing the filing application may include leveraging administrator-controlled user IDs to allow access to specific datasets as well as workflow to track tasks at the RIC or fund level. Multi-level data security permissions (read/write) can also enhance the application control environment

Summary reporting can control filing progress and can be used to track the progress of responsibilities as well as be used as a management tool to update internal personnel as needed. Additionally, establishing an audit trail for output is another control consideration for firms. Audit trail controls can include documenting data loads and edits by specific user ID, tracking value overrides and deltas, and operational oversight to ensure internal compliance procedures are met. In addition, optimizing automation in the XML generation and submission process can save time and effort as the filing deadline approaches, and can minimize manual intervention to make updates to XML data that would modify what has been approved.



**Who Is Affected**

The below representative functional model depicts the relative impact the SEC Modernization Rule may have on the functional and technology landscape of a typical RIC.

Sales and client management	Product management	Investment management	Trade support	Fund operations	Client servicing
Marketing	Product strategy and development	Securities research & knowledge mgmt.	Trade confirmation rec. and support	Transfer agency*	Fund reporting distributions to clients
Wholesaling	Product management	Portfolio management	Post-trade compliance	Custody	Investor support call center
Order fulfillment	Reporting and disclosure	Fund data support and management	Clearing	Fund accounting*	
		Pre-trade compliance	Settlement	Fund administration	
		Portfolio risk management		Fund operations support**	
		Service provider management and oversight		Portfolio and performance attribution	
				Operations risk management	

\* Functions are typically outsourced to a third-party service provider

\*\* Includes Shared Services (e.g., Legal, Compliance, Information Technology Support).

Data management technology									
Customer relationship management	Product platforms	Analytics	Risk metrics	Order entry	Trade processing	Data sources/repositories	Books & records	Performance calculation engine	Reporting
				Mutual fund modernization impact					



### What are firms thinking about now?

Many organizations are in varying stages of mobilizing to respond to the SEC Modernization Rule. Over the coming months, these organizations are expected to initiate planning, assess internal capabilities, and engage externally to accelerate understanding of and compliance with the rule.

#### 1) Initiate planning

- Outline roadmap to guide implementation of systems and processes to support compliance with the Modernization Rule
- Assemble a dedicated team of business, operational, compliance, technology, and legal representatives
- Develop an understanding of the final Modernization Rule
- Identify the strategic impact of the Modernization Rule on current organizational initiatives
- Build a business case and seek funding to implement and operate target operating model

#### 2) Assess capabilities

- Analyze the impact of changes to technology, such as regulatory reporting system upgrades, to meet the requirements of the rule and amendments
- Identify whether current data architecture can satisfy rule requirements
- Determine the impact of the final requirements on existing regulatory reporting processes

#### 3) Engage externally

- Consult with existing custodian(s), fund administrator(s), intermediaries, and other external parties to identify operational and technology gaps, especially for RICs that rely on external service providers to support regulatory reporting activities
- Evaluate transformative opportunities to reduce duplicative reporting functions and enhance the current operating model ●

#### To the point:

- The SEC's new Modernization Rule requires increased reporting and disclosure requirements for certain RICs.
- Industry changes were the drivers for the new requirements, such as new product structures, technological advances, data aggregation and analysis, reporting relevance, and the SEC's need to identify trends and analyze data.
- Some challenges for implementation: data sourcing, implementation and filing timelines, more complex calculations, and identifying where data aggregation and reporting would reside.
- Potential opportunities stemming from the changes: centralizing data, automating reporting, enhanced oversight.
- Companies will need to assess their processes, data, and technology infrastructure to understand how they will meet the new requirements.

Specifically, the introduction of secure, easily accessible data sources such as the cloud, firm web portals, and other automated web-based solutions have emerged as primary tools for sharing and analyzing information.