

MEMO# 29242

August 11, 2015

ICI Files Comment Letter on SEC Proposal for Fund Reporting Requirements and Shareholder Report Delivery

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TO:

ACCOUNTING/TREASURERS MEMBERS No. 18-15
BANK, TRUST AND RETIREMENT ADVISORY COMMITTEE No. 29-15
BROKER/DEALER ADVISORY COMMITTEE No. 39-15
CHIEF RISK OFFICER COMMITTEE No. 20-15
CLOSED-END INVESTMENT COMPANY MEMBERS No. 26-15
COMPLIANCE MEMBERS No. 23-15
DERIVATIVES MARKETS ADVISORY COMMITTEE No. 59-15
ETF (EXCHANGE-TRADED FUNDS) COMMITTEE No. 19-15
FIXED-INCOME ADVISORY COMMITTEE No. 26-15
INVESTMENT ADVISER MEMBERS No. 19-15
MONEY MARKET FUNDS ADVISORY COMMITTEE No. 29-15
REGISTERED FUND CPO ADVISORY COMMITTEE
SEC RULES MEMBERS No. 49-15
SMALL FUNDS MEMBERS No. 36-15
TRANSFER AGENT ADVISORY COMMITTEE No. 40-15
UNIT INVESTMENT TRUST MEMBERS No. 4-15
VARIABLE INSURANCE PRODUCTS ADVISORY COMMITTEE No. 17-15

RE:

ICI FILES COMMENT LETTER ON SEC PROPOSAL FOR FUND REPORTING REQUIREMENTS AND SHAREHOLDER REPORT DELIVERY

As previously reported, [\[1\]](#) the Securities and Exchange Commission (“SEC” or “Commission”) recently issued two proposals (“Proposals”) that would require registered investment companies (“funds”) to engage in additional and more frequent reporting of

portfolio holdings, allow funds to provide shareholder reports via websites, and require investment advisers to provide to the SEC information about their separately managed account businesses. [2] The ICI's comment letter (the "Letter") on the Proposals is attached and briefly summarized below.

In the Letter, we express broad support for the Proposals, although we also recommend that the SEC modify and improve them in some significant ways. Our intent with these recommendations is to enhance the final rule set, consistent with the SEC's policy goals, and provide reasonable alternatives to address the multitude of business, operational, and compliance challenges the Proposals present. [3]

The Letter points out that the SEC has not addressed how it intends to maintain the security of the Form N-PORT data it will collect from the fund industry, nor the extent to which it will be made accessible on a current basis to any parties other than the SEC. The SEC's storage of immense volumes of monthly fund data would create a vast, unique, single repository of structured data that undoubtedly will attract the attention of cyber criminals. That information, particularly industry-wide portfolio holdings, reflects the intellectual capital and very lifeblood of the fund business. The Letter states that we can support the SEC's monthly collection of fund portfolio holdings only to the extent that the SEC undertakes aggressive ongoing measures to protect the information it proposes to collect. These measures should include independent third-party testing and verification of the security of this information, prior to requiring firms to commence monthly filing of portfolio holdings on Form N-PORT and on an ongoing basis thereafter. We recommend in the Letter that the SEC initially collect fund portfolio holdings information quarterly with a sixty-day lag and begin collecting all of the other Form N-PORT information on a monthly basis. Experience with this enhanced data set would position the SEC to reevaluate the necessity of expanding its data collection to encompass complete fund portfolio holdings on a monthly basis.

Form N-PORT, Regulation S-X Amendments, and Form N-CEN

The Letter strongly supports the Commission's intention not to make public information filed on Form N-PORT for the first two months of the fund's fiscal quarter. It also supports the Commission's proposal to delay making public for 60 days the information that funds would report for the third month of the quarter.

The Letter additionally identifies certain information that should not be made public—risk metrics; delta for convertible securities, options, and warrants; illiquidity determinations; country of risk determinations; and proprietary information about derivatives and securities lending. We state that each of these items poses unique issues that necessitate non-public treatment. We therefore recommend moving disclosure of these items to Part D of Form N-PORT, which is proposed to be non-public, or to an additional non-public schedule to the Form.

The Letter points out that implementation of Form N-PORT will require firms, as well as third-party administrators and other service providers, to undertake significant systems development and operational updates and, in many cases, will require additional staffing. To provide the data the Commission requests in a tagged format, firms will need to coordinate data that currently resides in different systems or modify current systems. We therefore recommend that the Commission require funds to make monthly filings on Form

N-PORT 45, rather than 30, days after the end of the period, on a “T+1” accounting basis. We recommend that the SEC permit funds to submit Form N-CEN filings 75, rather than 60, days after the end of the period. We also request that the Commission permit funds to attach the first and third fiscal quarter-end Regulation S-X compliant portfolio holdings schedules to Form N-PORT within 60 days after the end of the reporting month, consistent with the filing deadline for current Form N-Q. We further request a 30-month compliance period after the effective date as the bare minimum necessary for filing the new forms for all funds, as well as an 18-month compliance period after the effective date for the Regulation S-X amendments.

Other comments, concerns and recommendations that appear in the Letter are summarized below.

Form N-PORT

With respect to proposed Form N-PORT, we make the following recommendations.

- Modify the proposed risk metrics standards to require funds to:
 - report the total portfolio duration and spread duration;
 - employ a *de minimis* five percent threshold to a foreign currency’s contribution to total duration before any risk metrics information about that currency is required to be reported or, alternatively, only require reporting of a single duration measurement that is a weighted average of the top five currencies (including the base currency) or those currencies that constitute at least 50% of the portfolio’s exposure; and
 - define “investment grade” consistent with a more conventional definition of that term, without reference to liquidity.
- Increase the risk metrics reporting threshold to an amount greater than 25% of a fund’s net asset value (“NAV”) determined over a three-month period and exclude index funds from risk metrics reporting.
- Require funds to disclose information only about the five securities lending counterparties to which a fund has the greatest exposure.
- Use a definition of “derivatives” consistent with accounting guidance to enable funds to appropriately determine whether to provide derivatives-related information about an instrument.
- Require disclosure of derivatives gain or loss information by contract type (e.g., futures, forwards, swaps, etc.) rather than by risk category (e.g., commodity contracts, credit contracts, equity contracts, etc.).
- Require funds using derivatives that are based on non-public indices or custom baskets to report only the largest 50 issues and the components that exceed one percent of the index or basket when the notional amount of the derivative exceeds five percent of the fund’s NAV. Do not require funds to disclose non-cash collateral received on the schedule of investments.

Forms N-PORT and N-CEN

With respect to proposed Forms N-PORT and N-CEN, we make the following recommendations.

- Explicitly state in any adopting release that funds may make and rely on reasonable judgments and assumptions in providing responses to Forms N-PORT and N-CEN.
- Permit funds to provide third-party Legal Entity Identifier (“LEI”) information based on

their reasonable belief that the information is accurate.

Regulation S-X

With respect to the proposed amendments to Regulation S-X, we make the following recommendations.

- Modify the written option contracts disclosure to omit written option notional amount.
- Require funds using derivatives that are based on non-public indices or custom baskets to report only the 50 largest issues and the components that exceed more than one percent of the index or basket when the notional amount of the derivative exceeds five percent of the fund's NAV. Require funds to provide a graphical depiction of portfolio holdings by country or geographic region and by industry, rather than a categorization of holdings by type, industry, and geographic region in the schedule of investments.
- Omit the proposed requirement to report federal income tax basis information for securities and derivatives by type.
- Modify financial reporting requirements to remove disclosure regarding *de minimis income*, eliminate the written options schedule, and incorporate the proposed derivatives schedules into the fund's financial statements rather than in the notes to the financial statements.

Proposed Rule 30e-3: Shareholder Report Delivery

In our Letter, we express strong support for proposed rule 30e-3, which would provide funds with an optional method to satisfy shareholder report transmission requirements by posting such reports online if they meet certain conditions. We recommend that the SEC also allow funds to deliver summary and statutory prospectuses via the Internet to shareholders using the same proposed delivery framework.

Our Letter also recommends that the Commission take a number of steps to facilitate the use of the proposed rule, reduce operational burdens, enhance consistency with existing requirements, increase efficiency, and provide additional cost savings for fund shareholders. Our recommended changes are highlighted immediately below.

- Modify the proposed requirement of a postage-paid reply form, and permit funds to provide a toll-free phone number **or** a pre-addressed, postage-paid reply form.
- Permit funds to mail shareholders a separate written statement ("Initial Statement") and a notice that each shareholder report is available online ("Notice") accompanied by other important account materials, such as new account welcome kits, account statements, dividend checks, and Notices for other funds.
- Give fund complexes or intermediaries the option to create a single, consolidated Notice for all of a shareholder's funds with the same fiscal year-end, so that the shareholder could receive a single Notice for those funds.
- Clarify that intermediaries would be able to fulfill obligations under rule 30e-3 on behalf of funds.
- Allow funds to add information to the Initial Statement and Notice giving shareholders the option to affirmatively consent to delivery via electronic mail ("e-delivery").
- Allow funds to "household" the Initial Statement in addition to the Notice.
- Permit shareholders' implied consent to cover all series and funds in which they are invested in any single fund complex, and all funds held through a single intermediary. Shareholders' implied consent should carry through to any new investments in that

fund complex or through that intermediary.

- Modify filing requirement for form of Notice, either requiring a subsequent filing of the form of Notice only when there is a change to the form of Notice, or permitting funds to file the form of Notice as an exhibit to Form N-CEN.
- Retain existing Commission guidance that permits funds to deliver shareholder reports by email to shareholders who affirmatively consent to e-delivery.
- Allow any fund to continue relying on proposed rule 30e-3 even if it did not meet the posting requirements of the rule for a temporary period of time because of technical difficulties.
- Continue to permit funds to provide shareholders access to a summary schedule of holdings in addition to the full schedule.

Form ADV Amendments and Amendments to Advisers Act Recordkeeping Rule

The Letter generally supports the SEC's collection of information from investment advisers about their separately managed account business. We also do not object to the Commission's proposed amendments to the recordkeeping rule to increase documentation of investment performance claims.

Dorothy M. Donohue
Deputy General Counsel - Securities Regulation

[Attachment](#)

endnotes

[1] See ICI Memorandum No. 29036 (May 28, 2015), available at http://www.ici.org/my_ici/memorandum/memo29036.

[2] *Investment Company Reporting Modernization*, 80 Fed. Reg. 33590 (June 12, 2015), available at <http://www.gpo.gov/fdsys/pkg/FR-2015-06-12/pdf/2015-12779.pdf> ("Fund Reporting Proposal"); *Amendments to Form ADV and Investment Advisers Act Rules*, 80 Fed. Reg. 33718 (June 12, 2015), available at <http://www.gpo.gov/fdsys/pkg/FR-2015-06-12/pdf/2015-12778.pdf> ("Adviser Reporting Proposal") (collectively the "Proposals").

[3] Our comments on the Adviser Reporting Proposal express broad support because we recognize the need for the Commission to obtain information to better monitor for risk, but they are not intended to address any particular aspect of the proposed amendments.