

MEMO# 29188

July 21, 2015

ICI Draft Comment Letter on SEC Proposal for Fund Reporting Requirements and Delivery of Shareholder Reports; Your Comments Requested by July 31

[29188]

July 21, 2015

TO:

ACCOUNTING/TREASURERS COMMITTEE No. 21-15
CHIEF RISK OFFICER COMMITTEE No. 19-15
CLOSED-END INVESTMENT COMPANY COMMITTEE No. 17-15
COMPLIANCE ADVISORY COMMITTEE No. 7-15
DERIVATIVES MARKETS ADVISORY COMMITTEE No. 55-15
ETF (EXCHANGE-TRADED FUNDS) COMMITTEE No. 18-15
ETF ADVISORY COMMITTEE No. 18-15
FIXED-INCOME ADVISORY COMMITTEE No. 24-15
INVESTMENT ADVISERS COMMITTEE No. 9-15
MONEY MARKET FUNDS ADVISORY COMMITTEE No. 25-15
REGISTERED FUND CPO ADVISORY COMMITTEE
SEC RULES COMMITTEE No. 24-15
SMALL FUNDS COMMITTEE No. 23-15
UNIT INVESTMENT TRUST COMMITTEE No. 7-15
VARIABLE INSURANCE PRODUCTS ADVISORY COMMITTEE No. 16-15

RE:

ICI DRAFT COMMENT LETTER ON SEC PROPOSAL FOR FUND REPORTING REQUIREMENTS AND DELIVERY OF SHAREHOLDER REPORTS; YOUR COMMENTS REQUESTED BY JULY 31st

As previously reported, [\[1\]](#) the Securities and Exchange 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]

ICI's draft comment letter (the "Letter") is attached and briefly summarized below. Please provide comments as soon as possible, but, in any event, no later than end of day on Friday, July 31. A number of us drafted the Letter, so please direct your comments as follows:

- On Forms N-PORT and N-CEN – to Sarah Bessin (sarah.bessin@ici.org) or Ken Fang (kenneth.fang@ici.org)
- On Regulation S-X – to Greg Smith (smith@ici.org)
- On shareholder report delivery – to Linda French (linda.french@ici.org) or Joanne Kane (joanne.kane@ici.org)
- On information security or the Adviser Reporting Proposal – to Linda French (linda.french@ici.org)

The Letter is due to the SEC by Tuesday, August 11.

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 proposed rules present.

Although the Letter expresses broad support for the Commission's efforts to modernize fund reporting, we express serious concerns about the SEC's ability to maintain the security of the data it proposes to collect from the fund industry, particularly monthly portfolio holdings information. The Letter states that, given these concerns, we support the SEC's monthly collection of fund portfolio holdings only to the extent, as explained more fully below, the SEC completes independent testing and verification of the security of this information by means of a third party review, and commits to vigorously protecting the data on an ongoing basis. We recommend in Letter that, while the SEC is analyzing its existing information security systems and implementing any necessary enhancements, the SEC 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.

A. Form N-PORT, Regulation S-X, 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 identifies certain information that should not be made public – risk metrics, illiquidity determinations, country of risk determinations, and proprietary information about derivatives and securities lending. We state that public disclosure of these information items is neither necessary nor appropriate for the public interest or for the protection of investors, and that public disclosure has the potential to confuse investors or harm funds and advisers. 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 makes the point that the proposed compliance dates do not reflect the complexity of the new data reporting requirements. We argue that the proposed compliance dates simply do not provide sufficient time for funds to engage in the multi-step process necessary to meet the very significant new filing responsibilities. We therefore recommend that the Commission require funds to make monthly filings 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 at any time prior to the sixtieth day after the end of the reporting period, consistent with the filing deadline for current Form N-Q. Under our recommended approach, funds still would file Form N-PORT with the Commission for the first and third quarters within 45 days after the end of the period. We further request a 30-month compliance period as the bare minimum necessary for filing the new forms for all funds, as well as an 18-month compliance period for the Regulation S-X amendments.

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

Form N-PORT

- **Modify risk metric standards.** The Commission should modify its proposed risk metric standards to require funds to report duration and spread duration at a single risk-free rate; employ a de minimis threshold of [one percent/five percent] of a foreign currency’s contribution to total duration before funds are required to report any risk metric information about that currency; and define “investment grade” without reference to liquidity.
- **Increase risk metric threshold and exclude index funds from providing risk metrics.** The Commission should increase the risk metric reporting threshold to 25% of a fund’s net asset value (“NAV”) determined over a three-month period and exclude funds that track indices from providing any risk metric information.
- **Limit securities lending disclosure to top five counterparties.** The Commission only should require funds to disclose information about the top five securities lending counterparties.
- **Require disclosure of derivatives gain/loss information by contract type.** The Commission should require disclosure of derivatives gain/loss information by contract type.
- **Require flow information at the omnibus account level.** The Commission should require funds to provide flow information only at the omnibus account level.
- **Revise the disclosure requirement for derivatives referencing non-public indices or custom baskets.** The Commission should require funds using derivatives that are based on non-public indices or custom baskets to show only the top 50 components and components that represent more than one percent of the index.
- **Modify reporting of securities lending collateral.** The Commission should not require funds to disclose collateral received on the schedule of investments.
- **Provide a reasonable belief standard for third-party Legal Entity Identifiers (“LEIs”).** The Commission should permit funds to provide third-party LEI information based on their reasonable belief that the information is accurate.
- **Explicitly state that funds may make and rely on reasonable assumptions.** The Commission should explicitly state in any adopting release that funds may make and rely on reasonable judgments and assumptions in providing responses to Forms N-

Regulation S-X

- Modify written open option contracts and open swap contracts disclosure. The Commission should modify its option and contracts disclosure to omit written option notional amounts; and require derivatives based on a non-public index or custom basket to report only the 50 largest issuers and the components that exceed one percent of the index.
- Provide pictorial of holdings by country or geographic region and by industry. The Commission should require funds to depict portfolio holdings by country or geographic region and by industry, rather than through an exhaustive list of securities by type, industry, and geographic region.
- Omit illiquidity determinations. The Commission should omit the requirement to report illiquidity determinations in a fund's publicly available financial statements.
- Omit Federal income tax cost basis. The Commission should omit the requirement to report federal income tax because it is redundant and unnecessary.
- Modify the statement of operations. The Commission should modify the Statement of Operations 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.

B. Proposed Rule 30e-3: Website Delivery of Shareholder Reports

In our Letter, we express strong support for proposed rule 30e-3, which would permit funds to transmit shareholder reports electronically. We point out that funds and their shareholders would benefit further if the SEC also allowed funds to deliver summary and statutory prospectuses via the Internet to shareholders expressing a preference for that manner of delivery rather than continuing to provide them print copies. Given the magnitude of potential cost savings that will be achieved simply by catering to investor preferences, we strenuously encourage the Commission to move expeditiously towards an implied consent framework for prospectuses.

Although our Letter supports proposed rule 30e-3, we also recommend 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 Letter recommends that the Commission make the modifications and clarifications provided immediately below.

- Remove postage paid reply form requirement. The Commission should allow funds to provide a toll-free phone number or a pre-addressed, postage paid reply form.
- Permit other important accompanying materials. The Commission should permit other important account materials, such as new account welcome kits, account statements, and dividend checks, to accompany Initial Statements and Notices. In addition, the Commission should permit funds to provide a shareholder with Notices from all funds with the same fiscal year-end in a single mailing.
- Clarify the role of intermediaries. The Commission should make clear that intermediaries would be able to fulfill obligations under Rule 30e-3 on behalf of funds.
- Permit Initial Statement and Notice to include option for affirmative consent to e-delivery. The Commission should allow funds to add information to the Initial

Statement and Notice giving shareholders the option to affirmatively consent to e-delivery.

- Permit “householding” of Initial Statement. The Commission should allow funds to “household” the Initial Statement in addition to the Notice, as is proposed.
- Allow consolidated consent to cover multiple funds. The Commission should permit shareholders’ consent to cover all series and funds in which they are invested in any single fund complex; and permit shareholders’ consent to cover all funds held through a single intermediary. The Commission should allow shareholders’ implied consent to carry through to any new investments in that fund complex or through that intermediary.
- Retain existing e-delivery guidance. The Commission should retain existing Commission guidance that permits funds to deliver shareholder reports by email to shareholders who affirmatively consent to e-delivery.
- Adopt a safe harbor provision. The Commission should 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.
- Retain summary schedule of holdings. The Commission should continue to permit funds to provide shareholder access to a summary schedule in addition to the full schedule.

C. Form ADV Amendments and Amendments to Advisers Act Recordkeeping Rule

The Commission’s Adviser Reporting Proposal would require investment advisers to provide additional information about their separately managed account business, including types of assets held, and the use of derivatives and borrowings in the accounts. The Letter generally supports the SEC’s collection of this data on the basis that it should better equip the SEC to analyze whether specific activities or practices pose risks to the markets or the financial system. We also do not object to the Commission’s proposed amendments to the recordkeeping rule to increase documentation of investment performance claims. We agree with the SEC that these amendments would codify what is already standard business practice in the fund industry.

Linda M. French
Counsel

[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”).

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