

# Memorandum

---

## SEC Proposes Amendments to Registered Fund Reporting Requirements; Focus on Alternative Funds

June 9, 2015

---

On May 20, 2015, the Securities and Exchange Commission (“SEC”) published [proposed rules](#) to modernize existing investment company reporting requirements (“Release”). The Release outlines a dramatic overhaul of the rules and forms that govern reporting by registered investment companies (“funds”). These aggressive proposals appear to be the SEC’s latest move in a brewing turf war with the Financial Stability Oversight Council (“FSOC”), as the SEC attempts to assert its primacy in regulating the asset management industry.

This Alert focuses on new information that funds will be required to report under the proposed amendments. The proposed amendments are designed to provide more information to the SEC, not to individual investors (the proposed filings will be in XML format, which is not easily readable). In the Release, the SEC indicates that it intends to utilize reported information to: (i) assess regulatory compliance; (ii) identify funds for examination; (iii) inform risk monitoring initiatives; and (iv) inform SEC policy. We interpret these proposals as being directed particularly at alternative funds, as the new reporting requirements will place a larger burden on funds operating in that space due to their bespoke investment strategies (with attendant potential constraints on liquidity) and use of derivatives. Comments on the proposed rules will be due 60 days after the Release is published in the *Federal Register*.

### Monthly Reporting on New Form N-PORT

The SEC proposes to rescind Form N-Q, which requires funds to file financial statements for the first and third fiscal quarters, and replace it with a new Form N-PORT. Form N-PORT would be filed with the SEC on a monthly basis, within 30 days of the end of each month. The report for each fiscal quarter would be made available to the public 60 days after the end of the quarter. For the reports filed at the end of the first and third fiscal quarters, the fund also would be required to include, as an exhibit, the schedule of investments

that would have been filed on Form N-Q. As this schedule would not be in XML format, investors will continue to have access to a fund's quarterly financial statements through this schedule and semi-annual and annual reports.

Form N-PORT would apply to all registered funds (including exchange-traded funds ("ETFs")), except for money market funds and small business investment companies. Additionally, Form N-PORT would be filed in a structured XML format, to facilitate collection and analysis of data by the SEC. Open-end funds will be familiar with the XML format, as they are currently required to file certain risk/return information in this format when they update certain sections of their registration statements (commonly referred to as an "XBRL" filing).

Form N-PORT would require funds to report significantly more information than is currently reported on Form N-Q. This Alert does not discuss all of the new reporting requirements associated with Form N-PORT, but below is a list of some of the more significant items that have been added.

#### Additional information about individual investments

- Identifier number/code for each investment (common identifiers, such as CUSIP numbers, may be used or codes may be internally generated by a fund if consistent for all funds in complex)
- Payoff profile of each investment (long, short or N/A)
- Asset type of each investment (short-term vehicle, repurchase agreement, type of equity security, type of derivative, etc.)
- Country of issuer and, if different, country of risk/economic exposure
- For each debt security, the maturity date and coupon, default status, whether interest payments are in arrears, the portion of interest paid in kind and whether coupon payments have been legally deferred by the issuer
- For each convertible security, whether the conversion right is mandatory or contingent, the conversion ratio, information about the asset into which the debt is convertible and the delta (ratio of the change in value of the option to the change in value of the asset into which the debt is convertible)
- For each derivative position, the category of the derivative, the name and Legal Entity Identifier ("LEI") of the counterparty, the terms and conditions relating to the payoff profile and, for certain common categories of derivatives, the monthly net realized gain (loss) and net change in unrealized appreciation (depreciation) attributable to such derivatives
- For each repurchase agreement and reverse repurchase agreement, whether each is cleared by a central counterparty, the name of the central counterparty or the name and LEI of the over-the counter counterparty, the repurchase rate, whether the position is a tri-party transaction, the maturity date, the

principal amount, the value of collateral posted and the category of investments that most closely represents the collateral

- For funds that invest through a controlled foreign corporation (“CFC”), such as a Cayman Islands subsidiary, the fund would need to report the individual investments held by the underlying CFC

#### Portfolio-level information

- Monthly returns information for the preceding three months (multi-class funds would report returns for each class)
- Risk metric calculations measuring exposure/sensitivity to changing market conditions, such as asset prices, interest rates, credit spreads
- For funds that invest 20% or more of their assets as of the reporting date in debt or derivatives with exposure to debt or interest rates, portfolio level calculation of duration and spread duration across applicable maturities of portfolio
- Funds would calculate the potential change in value in the fund’s portfolio from a 1bp duration change (DVo1) and 1bp spread duration change (SDVo1) in interest rates for each of 1-, 3- and 6-month and 1-, 2-, 3-, 5-, 7-, 10-, 20- and 30-year maturities

#### Securities lending information

- The name and LEI of each counterparty
  - For each investment held by a fund, the portion of investment on loan by the fund and the value of securities on loan
- For the portfolio as a whole, the aggregate value of all securities on loan to each counterparty, securities lending income, securities lending fees and the monthly average of the value of portfolio securities on loan

#### Liquidity risk information

- Market liquidity and pricing of portfolio investments, fund flows for each of the preceding three months, shares sold (including exchanges but excluding reinvested dividends/distributions), shares sold in reinvestments and shares redeemed or repurchased (including exchanges)

The Release notes that frequent reporting of such detailed information opens up the risk that a fund’s investment strategy could be reverse-engineered. We believe this risk may be amplified for alternative funds due to their unique investment strategies and the requirement that they report the individual holdings of CFCs. The Release also does not indicate the cyber-security standards that will be employed by the SEC to safeguard this valuable information that will be provided to it by the industry.

## Amendments to Regulation S-X

The SEC also proposed amendments to Regulation S-X to add requirements for standardized enhanced derivatives disclosure in financial statements. Similar disclosure will be required by Form N-PORT. Under the amendments to Regulation S-X, funds would be required to report open futures contracts, forward foreign currency contracts and swap contracts, include additional disclosure regarding fund holdings of written and purchased option contracts and move derivatives disclosure to the financial statements, as opposed to the current location in the notes to financial statements.

With respect to the notes to financial statements, the proposed amendments to Regulation S-X include additional requirements for disclosure of securities lending activities. The new information required to be reported includes: (i) gross income from lending, including income from cash collateral reinvestment; (ii) the dollar amount of all fees/compensation paid for securities lending activities and related services, including borrower rebates and cash collateral management services; (iii) net income from lending activities; (iv) the terms governing compensation of securities lending agent, including revenue share split (which has historically not been publicly disclosed by all registrants), with related percentage splice between the fund and the agent and/or any fee-for-services and description of services included; (v) the details of any other fees paid directly or indirectly; and (vi) the monthly average of the value of portfolio securities on loan.

## New Form N-CEN

The SEC proposes to rescind Form N-SAR, which requires funds to report semi-annual “census” information, and replace it with new Form N-CEN. Funds would be required to file Form N-CEN on an annual basis within 60 days of the end of the fiscal year, instead of semi-annually as is required currently for Form N-SAR. Form N-CEN would be filed in XML format, replacing the current MS-DOS format of Form N-SAR. Form N-CEN will carry over many of the same data elements currently reported on Form N-SAR, with certain changes. Below is a summary of some of the more significant changes proposed by the SEC.

Among the new information that would be reported on Form N-CEN is information related to securities lending, including fee information, information on relationships with certain lending-related service providers, borrower default information, information on payments made to the fund’s securities lending agent and the name of the securities lending agent and cash collateral manager. Funds also would be required to report certain information regarding their directors, including names, “interested person” status and SEC file numbers of any other fund for which they serve as a director. Form N-CEN will also require information regarding a fund’s chief compliance officer (“CCO”), including his or her name, CRD number, address and phone number. Funds will also need to report if there has been a CCO change since the prior filing. Notably, the SEC states that this information will allow the SEC to contact a CCO directly.

Form N-CEN would require reporting of any financial support that a fund receives from its sponsor in an exhibit. Funds would also need to report reliance on any exemptive orders, a new requirement, and reliance

on a broader list of exemptive rules than currently required by Form N-SAR. For example, Form N-CEN adds reliance on Rules 15a-4 (interim advisory agreements) and 17a-8 (affiliated mergers) to the list of exemptive rules covered on Form N-SAR. Form N-CEN will also ask specific questions about changes in a fund's valuation methodologies during the year.

ETFs, exchange-traded managed funds (ETMFs) and index and master feeders funds would be required to provide additional information on Form N-CEN, such as tracking error, relative performance and information regarding authorized participant activity and primary market transactions (to the extent applicable). Closed-end funds would be required to report additional information on rights and secondary offerings not currently required by Form N-SAR.

In comparing Form N-SAR to Form N-CEN, the SEC notes that it is proposing to eliminate certain items otherwise reported to the SEC in XML format, such as fee and expense information that is included in open-end fund XBRL filings. A chart with a complete list of Form N-SAR items is included starting on page 247 of the [SEC rule proposal](#), noting whether each item would be modified or omitted in Form N-CEN.

### **New Rule 30e-3**

The SEC also proposed a new rule, Rule 30e-3, which provides funds with the option to transmit shareholder reports to investors by posting them online. This option would allow funds to avoid the costs associated with printing and mailing shareholder reports. A fund would be able to rely on Rule 30e-3 if certain conditions are met. First, the online report must be free and be publicly accessible. Second, shareholders must consent to receiving electronic reports. Third, notice must be printed and mailed to shareholders in connection with each report. Fourth, a hard copy of the report must be delivered, free of charge, upon request from shareholders. In order to obtain consent, a fund must send a statement to shareholders 60 days before relying on the rule. The statement must be a separate document and cannot be combined with any other materials except for the fund's summary prospectus, statutory prospectus, statement of additional information or notice of internet availability of proxy materials. A fund may assume negative consent if it does not receive any communication from a shareholder within 60 days of mailing the statement indicating that the shareholder would like to opt out of online reports. Separate consents would be needed for each series of a series company. As proposed, Rule 30e-3 only requires consent once from each shareholder.

### **Proposed Compliance Dates**

With respect to Form N-PORT, the SEC proposed a compliance date of 18 months after the effective date for fund groups with assets under management of \$1 billion or more (which is an exceedingly low threshold for the mutual fund industry that encompasses the vast majority of issuers). For complexes with less than \$1 billion in assets under management, the SEC proposed a later compliance date of 30 months from effective

date. The amendments to Regulation S-X would have a compliance date of eight months after the effective date. Form N-CEN would have a compliance date of 18 months after the effective date for all funds. Rule 30e-3 would be effective immediately.

We expect significant comment from the industry, particularly with respect to information that will be burdensome to compile and/or is particularly sensitive from a competitive standpoint. There are many in the fund industry who broadly support the SEC's efforts to assert its primary regulatory authority over the asset management industry, fearful of the consequences of having other regulators that operate in a prudential, as opposed to rules-based, manner (and further still, prudential regulators without a deep knowledge of the industry). People of that view will support the general efforts embodied in the proposal, and of course all industry participants welcome the flexibility provided for electronic delivery of shareholder reports. That said, early indications are that many believe, as do we, that the breadth of the proposal is an overreach, at least in parts, and that, at a minimum, the SEC's first-year burden estimates of 32 hours for the annual Form N-CEN filing and 198 hours for twelve Form N-PORT filings greatly underestimate the effort that will need to be undertaken to comply with these proposals, if adopted in their current form.

---

For further information, please contact one of the following members of the Firm's Registered Funds Practice.

NEW YORK CITY

---

**Sarah E. Cogan**  
+1-212-455-3575  
[scogan@stblaw.com](mailto:scogan@stblaw.com)

WASHINGTON, D.C.

---

**Rajib Chanda**  
+1-202-636-5543  
[rajib.chanda@stblaw.com](mailto:rajib.chanda@stblaw.com)

---

*The contents of this publication are for informational purposes only. Neither this publication nor the lawyers who authored it are rendering legal or other professional advice or opinions on specific facts or matters, nor does the distribution of this publication to any person constitute the establishment of an attorney-client relationship. Simpson Thacher & Bartlett LLP assumes no liability in connection with the use of this publication. Please contact your relationship partner if we can be of assistance regarding these important developments. The names and office locations of all of our partners, as well as our recent memoranda, can be obtained from our website, [www.simpsonthacher.com](http://www.simpsonthacher.com).*



**UNITED STATES**

New York  
425 Lexington Avenue  
New York, NY 10017  
+1-212-455-2000

Houston  
600 Travis Street, Suite 5400  
Houston, TX 77002  
+1-713-821-5650

Los Angeles  
1999 Avenue of the Stars  
Los Angeles, CA 90067  
+1-310-407-7500

Palo Alto  
2475 Hanover Street  
Palo Alto, CA 94304  
+1-650-251-5000

Washington, D.C.  
1155 F Street, N.W.  
Washington, D.C. 20004  
+1-202-636-5500

**EUROPE**

---

London  
CityPoint  
One Ropemaker Street  
London EC2Y 9HU  
England  
+44-(0)20-7275-6500

**ASIA**

---

Beijing  
3919 China World Tower  
1 Jian Guo Men Wai Avenue  
Beijing 100004  
China  
+86-10-5965-2999

Hong Kong  
ICBC Tower  
3 Garden Road, Central  
Hong Kong  
+852-2514-7600

Seoul  
West Tower, Mirae Asset Center 1  
26 Eulji-ro 5-gil, Jung-gu  
Seoul 100-210  
Korea  
+82-2-6030-3800

Tokyo  
Ark Hills Sengokuyama Mori  
Tower  
9-10, Roppongi 1-Chome  
Minato-Ku, Tokyo 106-0032  
Japan  
+81-3-5562-6200

**SOUTH AMERICA**

---

São Paulo  
Av. Presidente Juscelino  
Kubitschek, 1455  
São Paulo, SP 04543-011  
Brazil  
+55-11-3546-1000