

3 November 2016

*Practice Groups:**Investment Management, Hedge Funds and Alternative Investments**Broker-Dealer**Derivatives & Structured Products**Global Government Solutions**Hedge Funds and Venture Funds*

## SEC Issues Investment Company Reporting Modernization Rules

*By Yoon Y. Choo, Lucie G. Enns and Alyssa B. King*

### Table of Contents

Overview.....	1
New Form N-PORT.....	7
New Form N-CEN.....	13
Amendments to Regulation S-X.....	17
Amendments to Forms Relating to Securities Lending Activities.....	21
Website Transmission of Shareholder Reports.....	21

### Overview

On October 13, 2016, the Securities and Exchange Commission (“SEC”) adopted significant reforms under the Investment Company Act of 1940, as amended (“1940 Act”), that impose extensive new disclosure and reporting obligations on most registered investment companies (“funds”) (collectively, the “Reporting Rules”).<sup>1,2</sup> Over the last twenty years, the fund industry has seen the introduction and growth of new products, such as exchange-traded funds (“ETFs”), target date funds, and non-traditional bond funds, as well as the use of increasingly complex strategies and practices, including an increase in the use of derivatives by some funds. According to the Adopting Release for the Reporting Rules, the SEC believes that information that funds are currently required to report lags the evolution of the fund industry. The SEC has also begun to leverage technology by using structured and interactive data formats that allow it to collect and analyze information reported by funds more efficiently and effectively. The Reporting Rules are intended to bring fund reporting up to date with these developments.

The Reporting Rules greatly expand the volume of information regarding fund portfolio holdings and investment practices that must be disclosed. Moreover, the Reporting Rules mandate that most of the new information be submitted in extensible markup language (“XML”) — a structured data format that will increase the transparency of submitted data, permitting the SEC and third parties to efficiently collect, aggregate and analyze the new information. Thus, with the adoption of the Reporting Rules, the SEC will acquire a potentially powerful new database of information that will permit it to assess risk at the fund-specific level, across different types of funds, and across the industry as a whole. The SEC has stated that it expects to use the data collected under the new reporting regime to, among other things, assess fund regulatory compliance, identify funds for examination, monitor risk, and inform rulemaking. As SEC Chair Mary Jo White stated in her opening remarks at the

## SEC Issues Investment Company Reporting Modernization Rules

open meeting during which the Reporting Rules were approved, “[t]his modernized reporting framework will, in short, fundamentally change how the [SEC] and investors can monitor and assess funds, including their potential risks.”<sup>3</sup>

**Reporting Rules at a Glance.** The Reporting Rules broaden and deepen the kinds of information that funds must disclose about their portfolio holdings and investment practices. The Reporting Rules introduce new Forms N-PORT and N-CEN which will replace currently effective Forms N-Q and N-SAR, respectively. Both new forms must be submitted in XML format and are primarily designed for use by the SEC and its staff to facilitate their oversight of the fund industry. The SEC also adopted amendments to Regulation S-X to enhance and standardize derivatives disclosure furnished in fund financial statements and amendments to certain registration statement forms (or, in the case of closed-end funds, Form N-CSR) to increase information funds provide to investors regarding their securities lending activities.

- **New Form N-PORT** replaces Form N-Q and requires funds, including ETFs organized as unit investment trusts (“UITs”) (but not money market funds (“MMFs”) and small business investment companies (“SBICs”)), to file new Form N-PORT in XML format. Form N-PORT requires that portfolio-wide and position-level holdings data be filed with the SEC on a monthly basis no more than 30 days after the close of each month.<sup>4</sup> Registrants offering multiple series will be required to file a separate report on each series, even if some information is identical for two or more series. Like Form N-Q, Form N-PORT would be submitted on the SEC’s Electronic Data Gathering, Analysis, and Retrieval database (“EDGAR”).

New Form N-PORT requires extensive information beyond that required in Form N-Q, including, notably:

- additional position-level information for all investments;
- detailed position-level information about the characteristics and terms of debt securities, repurchase and reverse repurchase agreements, and derivatives contracts;
- for funds with debt instruments, or derivatives that provide notional exposure to debt instruments or interest rates, that represent more than 25% of the fund’s net asset value (“NAV”), quantitative risk metrics data that measures such fund’s sensitivity to changes in interest rates, credit spreads and asset prices;
- the values of securities on loan, securities representing reinvestment of cash collateral, and securities representing non-cash collateral;
- information about securities lending counterparties and counterparty exposures;
- monthly total returns and monthly fund flows for each of the preceding three months, and monthly net realized gain or loss and net change in unrealized appreciation or depreciation attributable to derivatives and, separately, non-derivatives;
- information about controlled foreign corporations (“CFCs”) and their underlying investments; and
- legal entity identifiers (“LEIs”) for funds and their series.

*Importantly, Form N-PORT states that a fund may use its own internal methodologies and the conventions of its service providers when responding to items on the form, so long as the methodologies and conventions are consistent with the way the fund reports internally*

## SEC Issues Investment Company Reporting Modernization Rules

*and to current and prospective investors, and with any instructions or guidance from the SEC relating to the form.*

While Form N-PORT must be filed monthly, only information reported for the third month of a fund's fiscal quarter will be made publicly available, and then only after 60 days following the end of the fund's fiscal quarter. Some information submitted on Form N-PORT will not be made public even if made on Form N-PORT filings that are subsequently made public. (See "*Information Submitted Confidentially*" on page 13.)

- **New Form N-CEN** replaces Form N-SAR as the form on which funds must report certain census-type information. While Form N-CEN retains many of the disclosure items currently required by Form N-SAR, the new form substantially updates required disclosure items for all funds and includes new questions tailored to specific fund types. According to the Adopting Release, Form N-CEN also attempts to streamline reporting by eliminating disclosure of information reported elsewhere and information deemed no longer relevant. Like Form N-PORT, Form N-CEN also must be filed in XML format on EDGAR.

New information required by Form N-CEN includes, notably:

- information on securities lending transactions, securities lending agents and cash collateral managers, and types of payments to such agents;
- information on financial support received from certain affiliated entities;
- information specific to ETFs and exchange-traded managed funds ("ETMFs");
- additional information on UITs that are investment company separate accounts;
- additional information on closed-end funds and SBICs;
- class information for open-end funds;
- identification of a fund's reliance on SEC exemptive orders and certain SEC rules;
- information on NAV error corrections; and
- information on a fund's pricing vendors.

In contrast to Form N-SAR, which is reported semi-annually within 60 days after the end of a fund's fiscal year and second fiscal quarter (but annually for UITs 60 days after the close of the calendar year), a fund must file Form N-CEN within 75 days of the fund's fiscal year end. A fund with multiple series having different fiscal year ends must file a separate report covering all series with the same fiscal year end. A UIT must file one Form N-CEN within 75 days of the calendar year end. Like Form N-SAR, all information on Form N-CEN is publicly available immediately upon filing.

- **Amendments to Regulation S-X** mandate, among other changes, enhanced and standardized derivatives disclosure in the financial statements included in funds' registration statements and shareholder reports. Funds will be required to present information on their derivatives investments prominently in the funds' financial statements rather than in the notes to the financial statements. As amended, Regulation S-X requires funds to provide detailed information on holdings in open futures contracts, open forward foreign currency contracts, and open swap contracts, as well as to provide additional disclosure on written and purchased options. The disclosure requirements are

## SEC Issues Investment Company Reporting Modernization Rules

similar to the derivatives disclosure requirements of Form N-PORT. According to the SEC, the amended disclosure requirements are intended to provide investors with access to similar information in a reader-friendly format and to promote comparability in derivatives disclosure across funds by standardizing such disclosure to help investors better assess funds' use of derivatives. The amendments to Regulation S-X also augment reporting requirements for other investments, including disclosure relating to investments in fund affiliates, and revise rules prescribing the form and content of fund financial statements.

- **Amendments to Forms Relating to Securities Lending Activities.** The Reporting Rules amend Forms N-1A and N-3 to require additional disclosure regarding securities lending activities in funds' statements of additional information ("SAI") (or, in the case of closed-end funds, Form N-CSR) including disclosure of gross and net income from securities lending activities and fees and/or compensation paid by funds in connection with these activities.

***Disclosure Mandated by the SEC's New Liquidity Risk Management and Swing Pricing Rules.*** Concurrently with the adoption of the Reporting Rules, the SEC adopted new and amended rules impacting open-end funds' liquidity management. New Rule 22e-4 under the 1940 Act requires open-end funds (other than MMFs) to adopt liquidity risk management programs and disclose liquidity-related information.<sup>5</sup> Amendments to Rule 22c-1 under the 1940 Act permit, but do not require, open-end funds (other than MMFs and ETFs) to use "swing pricing" — a process of adjusting the NAV of fund shares so that purchasing or redeeming investors would bear a portion of the costs of entering or exiting the fund under certain circumstances.<sup>6</sup> Please see our Client Alert on the SEC's new liquidity risk management and swing pricing rules for more information.

As relevant to disclosure in Forms N-PORT and N-CEN, the liquidity risk management and swing pricing rules will require that affected funds report additional information as follows:<sup>7</sup>

- **Additional Form N-PORT Disclosure.** (1) Information about fund liquidity, including the classification of each portfolio investment into one of four liquidity categories; (2) the aggregate percentage of a fund's portfolio invested in each of the four liquidity categories; (3) if applicable, a fund's highly liquid investment minimum; and (4) the percentage of a fund's highly liquid investments pledged to satisfy margin requirements for derivative transactions that are not classified as highly liquid (together, "Liquidity-Related Information"); and
- **Additional Form N-CEN Disclosure.** (1) Information on availability and use of lines of credit, and interfund borrowing and lending ("Lending/Borrowing Information"); and (2) if applicable, a fund's swing factor upper limit and whether the fund engaged in swing pricing during its last fiscal year ("Swing Pricing Information").

### ***Status of Proposed Rule on Website Transmission of Shareholder Reports.***

In the proposing release for the Reporting Rules, the SEC proposed Rule 30e-3 under the 1940 Act, which would permit, but not require, funds to provide shareholder reports online if certain conditions are met, unless a shareholder elects to receive paper copies via mail.<sup>8</sup> The SEC postponed action on proposed Rule 30e-3 pending further study by its staff. Chair White has directed the SEC staff to prepare a recommendation for the SEC's consideration by year end.

## SEC Issues Investment Company Reporting Modernization Rules

### Compliance Dates:

Form N-PORT	Funds and fund groups with net assets of over \$1 billion as of the end of their most recent fiscal year ("Larger Funds").	The compliance date for Form N-PORT is June 1, 2018. Thus, Larger Funds must file their first Form N-PORT by July 30, 2018. Larger Funds will not have to report Liquidity-Related Information until they file Form N-PORT reflecting month-end data as of December 31, 2018, which must be filed by January 31, 2019.
	Funds and fund groups with net assets of less than \$1 billion as of the end of their most recent fiscal year ("Smaller Funds").	The compliance date for Form N-PORT is June 1, 2019. Smaller Funds will be required to report all information required by Form N-PORT, including Liquidity-Related Information, beginning with their first Form N-PORT filing on July 30, 2019.
	<p>The SEC will permit funds to file test submissions during a trial period. With the exception of portfolio holdings information attached as exhibits to Form N-PORT for the first and third quarters of a fund's fiscal year, all reports filed on Form N-PORT for the first six months following June 1, 2018 will be non-public. Form N-Q will be rescinded on August 1, 2019.</p> <p>The compliance date for a related amendment to the Form N-CSR certification requirements is June 1, 2018 for Larger Funds, and June 1, 2019 for Smaller Funds. Please see "<i>Rescission of Form N-Q and Amendment of Form N-CSR Certification Requirements</i>" on page 13 for more information.</p>	
Form N-CEN	<p>The SEC set a compliance date of June 1, 2018 for all funds. The Adopting Release does not provide as much detailed guidance on the Form N-CEN compliance date, as it does for Form N-PORT, and it is possible that the SEC staff may provide additional information in the future. However, given that the SEC did not provide a rolling compliance date (i.e., the next applicable fiscal period end after the compliance date) and that Form N-SAR will be rescinded on June 1, 2018, we believe that funds should make their last Form N-SAR filing by May 31, 2018. Thereafter, funds should report on Form N-CEN within 75 days of the fund's fiscal year end (75 days after the calendar year end for UITs).</p>	
	<p>The compliance date for a related amendment to the Form N-CSR exhibit requirements is also June 1, 2018. Please see "<i>Form N-CSR Change Related to New Form N-CEN</i>" on page 17 for more information.</p>	
	<p>Reporting of Lending/Borrowing Information will not be required until December 1, 2018 for Larger Funds, and June 1, 2019 for Smaller Funds. Reporting of Swing Pricing Information will be required 24 months after the date amended Rule 22c-1 is published in the Federal Register.</p>	
Amendments to Regulation S-X and Forms Relating to Securities Lending Activities	<p>The SEC set a compliance date of August 1, 2017 for the amendments to Regulation S-X and the amendments to forms relating to securities lending disclosure. Given that the SEC did not provide for a rolling compliance date, we believe that shareholder reports and registration statements filed on or after August 1, 2017 should comply with these new disclosure requirements.</p>	

## SEC Issues Investment Company Reporting Modernization Rules

***Implications of the Reporting Rules.*** Compliance with the Reporting Rules will likely result in significant costs to funds and their shareholders and require additional other resources to implement. Especially with respect to information required for Form N-PORT, most funds will be required to collect, process, and validate large amounts of data that may not have been previously collected or that may not have been processed in the manner and within the 30-day timeframe mandated by the form. For instance, for a closed-end fund that invests in underlying private investment vehicles, collecting data from the underlying funds to determine valuation and strike its NAV may require the closed-end fund to alter the frequency or date at which it strikes NAV. Similarly, a sub-advised fund may need to allot time to collect any necessary information maintained by third-party sub-advisers. Ultimately, funds will be responsible for compiling and validating the information to be reported, reconciling information across multiple form types, and timely submitting filings with the SEC.

Further, the SEC's ability to efficiently process and analyze the new information will have important consequences for funds with respect to SEC examinations and enforcement actions. As noted above, the SEC has stated that the new data will be used, among other things, to identify funds for examination. For example, Form N-PORT requires funds to report monthly total returns for each of the preceding three months. The SEC notes that analysis of this information may reveal performance outliers or highlight performance that appears inconsistent with a fund's investment strategy or other benchmarks, prompting further inquiries from the SEC staff. The SEC staff also may base its selection of funds for examination on industry-wide analysis of data relating to discrete risks, which will allow it to more readily target funds that fit a specific risk profile. With the adoption of the Reporting Rules, the SEC staff also will have in its possession more information about a fund's particular investment practices at the outset of an exam, possibly resulting in more focused exams. Whether the SEC's access to this new data will lead to an increase in enforcement actions or a change in the nature of such actions remains to be seen, though we expect that funds will be sensitive to the potential for increased regulatory scrutiny.

Many commenters on the Proposing Release requested that the SEC address its data security plans in light of the sensitivity and sheer volume of the non-public data that will be submitted on Form N-PORT. The SEC responded in the Adopting Release that its staff is studying relevant data security protocols and working to design controls and systems to maintain the confidentiality of non-public Form N-PORT data. In light of the growing threats to data security, funds may wish to consider the potential impact of any cybersecurity breach of the SEC's databases that compromises a fund's non-public information. While a fund's response to any such breach will likely depend on its investment strategies and the scope of the compromised information, funds may wish to assess the need for contingency planning.

***Preparing to Comply with the Reporting Rules.*** Preparing to comply with the Reporting Rules will be a lengthy process involving many different constituencies. Funds that are beginning this process may consider taking the following steps:

- Assimilate and develop a strong understanding of the Reporting Rules to determine the precise scope of the additional data to be reported. The reporting burden will vary significantly depending on a fund's investments. Funds that have significant debt exposure or engage significantly in derivatives or securities lending transactions will likely have greater reporting responsibilities than funds that do not;

## SEC Issues Investment Company Reporting Modernization Rules

- Establish working teams, allocate responsibilities to the teams, and develop timeframes within which major milestones should be completed. Working teams should be responsible for coordination among operational, compliance, management and other functions within their own organization, as well as coordination with other relevant service providers that support fund reporting;
- Assess to what extent current systems may be able to meet the new data requirements and whether service provider systems may need to be modified or developed. We expect to see extensive consultations between funds and their service providers regarding the infrastructure, networks, processes, and controls needed to source, collect, process, validate, and report the new information. In the course of these consultations, it is likely that service providers will furnish their fund clients with a detailed description of the data that resides on their systems or that can be collected or processed on their systems;
- Determine whether existing resources are adequate to establish and maintain the necessary reporting systems, including whether the necessary infrastructure, personnel, and expertise exist to perform the new functions, or, whether additional resources will be needed;
- Consider cost implications with service providers. A service provider may need to modify its existing systems or develop new systems to collect, process, or report the required information. Service providers may seek to pass on some or all of these costs to funds in the form of higher fees. In addition, the costs borne by any particular fund will depend on the level of services to be provided by the service provider to that fund;
- Review service provider contracts to determine what, if any, new services are covered by existing contract provisions and whether other contract provisions should be amended in light of the service provider's expanded responsibilities;
- For funds that invest in derivatives which may require the fund to publicly disclose the components of any non-public index or custom basket, consider whether licensing or other agreements need to be revised to permit such disclosure; and
- Develop a process for reporting to the fund's board of directors/trustees on progress in preparing for the new reporting requirements.

The remainder of this Client Alert will provide a more detailed look at new Forms N-PORT and N-CEN, amendments to Regulation S-X, as well as amendments to other forms that, together, comprise the SEC's revised fund reporting regime. We also will briefly discuss the public reaction to proposed Rule 30e-3 and its current status. Attorneys in our Investment Management Practice Group are available to discuss the Reporting Rules with you and answer any specific questions that you may have as the industry transitions to compliance with the Reporting Rules.

### New Form N-PORT

Form N-PORT is comprised of the following principal reporting components.

#### ***Part A: General Identifying Information.***

- ***LEI Disclosure.*** A fund must provide its LEI and that of each series.<sup>9</sup> A fund that does not have an LEI will be required to obtain one.<sup>10</sup> The inclusion of an LEI is intended to

## SEC Issues Investment Company Reporting Modernization Rules

facilitate the ability of the SEC and other third parties to link the data reported on Form N-PORT with data from other fund filings or from other sources; and

- **Other General Information.** A fund is also required to report its Central Index Key (“CIK”) and series identifiers and general identifying information similar to that currently reported on Form N-Q.

### *Part B: Disclosure of Portfolio-Level Information.*

A fund must report the following information for itself and its consolidated subsidiaries.

- **Assets and Liabilities:**
  - Its total assets, total liabilities, and net assets;
  - Assets attributable to any “miscellaneous securities” held in its portfolio (see the discussion of “*Part D: Miscellaneous Securities*” on page 12);
  - Assets invested in any CFC for the purpose of investing in certain types of investments, such as commodities and commodity-linked derivatives. A fund must disclose each underlying investment held by a CFC in addition to the investment in the CFC itself; and
  - The amount of certain liabilities, including (1) borrowings attributable to notes payable, bonds, and similar debt, (2) payables for investments purchased on a delayed delivery, when-delivered, other firm commitment basis, or on a standby commitment basis, and (3) the liquidation preference of outstanding preferred stock issued by a fund.
- **Portfolio-Level Risk Metrics.** A fund must report certain portfolio-level risk metrics, which provide measurements of a fund’s exposure to changes in interest rates, credit spreads, and asset prices:<sup>11</sup>
  - *Interest rate risk calculations.* If the average value of a fund’s debt securities, or derivatives that provide exposure to debt securities or interest rates, for the previous three months represents more than 25% of such fund’s NAV (“25% debt exposure”), the fund must provide, for each currency with a value of 1% or more of the fund’s NAV, the hypothetical change in value of its portfolio resulting from both a 1 basis point and 100 basis points change in interest rates (DV01 and DV100) at the following maturity intervals: 3 months, 1 year, 5 years, 10 years, and 30 years; and<sup>12,13</sup>
  - *Credit spread risk calculations.* A fund with more than 25% debt exposure must also report the hypothetical change in value of its portfolio resulting from a 1 basis point change in credit spreads (SDV01) where the shift is applied to the option adjusted spread, aggregated by both investment grade and non-investment grade exposures at the following maturity intervals: 3 months, 1 year, 5 years, 10 years, and 30 years.
- **Securities Lending.** A fund that engages in securities lending must report the name and LEI of each securities lending counterparty and the aggregate, portfolio-level value of all securities on loan to each counterparty. If a fund received non-cash collateral from a securities lending counterparty, the fund must so indicate, and if the non-cash collateral is not included in the fund’s schedule of portfolio investments (i.e., not treated as a fund asset), the fund must report the aggregate principal amount and aggregate value of each

## SEC Issues Investment Company Reporting Modernization Rules

type of non-cash collateral received, and the category of investments that most closely represents the collateral.

- **Return Information.** A fund must report monthly total returns for each of the preceding three months, calculated using the same methodologies used to calculate return information in the performance table for the risk-return summary of a fund's prospectus.<sup>14</sup> A multiple share class fund must report returns for each class. A fund must also report, for each of the preceding three months, monthly net realized gain (or loss) and net change in unrealized appreciation (or depreciation) attributable to derivative investments and, separately, non-derivative investments. With respect to derivatives, this information must be reported by both asset category (e.g., commodity contracts, credit contracts or equity contracts) as well as by the type of derivative instrument (e.g., forward, future, option or swap).
- **Flow Information.** For each of the preceding three months, a fund must report the total NAV of: (1) shares sold (including exchanges but excluding reinvestments of dividends and distributions); (2) shares sold in connection with reinvestments of dividends and distributions; and (3) shares redeemed or repurchased (including exchanges). If fund shares are held in omnibus accounts, net sales and redemptions from such accounts may be used for the flow calculation.
- **Liquidity Information.** As mentioned earlier, concurrently with the adoption of the Reporting Rules, the SEC adopted rules mandating that open-end funds (but not MMFs) adopt liquidity risk management programs and disclose liquidity-related information.<sup>15</sup> Relevant to Form N-PORT, at the portfolio level, a fund must disclose:
  - *Portfolio-level liquidity classifications.* The aggregate percentage of its investments classified in one of four categories — highly liquid, moderately liquid, less liquid, and illiquid;
  - *Highly liquid investment minimum.* If applicable, a fund's highly liquid investment minimum and the number of days a fund's holdings in assets that are classified as highly liquid investments fell below that minimum during a given reporting period, if any. This information is submitted confidentially and will remain non-public; and
  - *Highly liquid investments pledged to satisfy margin requirements.* The percentage of a fund's highly liquid investments that are segregated or pledged to satisfy margin requirements for derivatives transactions that a fund has classified as a moderately liquid, less liquid, or illiquid investment.

**Part C: Schedule of Portfolio Investments.** To facilitate the SEC's identification of individual portfolio securities and reference instruments of derivatives, a fund must report position-level information about each investment held by it and its consolidated subsidiaries as of the close of the preceding month's end.<sup>16</sup> Except with respect to portfolio holdings information filed under Part F: Exhibits, a fund is required to report portfolio information on Form N-PORT on the same basis that it uses to calculate its NAV, which is understood generally to be T+1 (trade date + 1).<sup>17</sup>

- **Position-Level Information for All Investments:**
  - *Identification of investment.* (1) The name of the issuer, (2) LEI of the issuer (if any), (3) title or a description of the investment, (4) Committee on Uniform Securities

## SEC Issues Investment Company Reporting Modernization Rules

Identification Procedures (“CUSIP”) number (if any), and (5) at least one other identifier (e.g., International Securities Identification Number (“ISIN”), ticker, or other unique identifier). As explained further below, a fund may report under a “miscellaneous securities” heading, without reporting position-level information, securities in an aggregate amount not exceeding 5% of its total assets if certain conditions are met;

- *Amount of investment.* (1) The balance (e.g., the number of shares, principal amount, units, or number of derivatives contracts), (2) the currency in which the investment is denominated, (3) the value in U.S. dollars and, if the investment is not denominated in U.S. dollars, the exchange rate used to calculate the value, and (4) the percentage value compared to the net assets of the fund;
- *Payoff profile (for non-derivative investments).* Whether the investment is held long, short or N/A. For derivatives, a fund should respond N/A and disclose this information in a section specific to derivatives as discussed below in “*Additional Position-Level Information for Derivatives*;”
- *Asset and issuer type.* The asset type (e.g., short-term investment, repurchase agreement, equity, debt, derivative, structured note, loan, asset-backed securities, commodity, real estate or other, with a brief description if “other” is selected); and (2) the issuer type (e.g., corporate, U.S. Treasury, U.S. government agency, U.S. government-sponsored entity, municipal, non-U.S. sovereign, private fund, registered fund or other, with a brief description if “other” is selected);
- *Country information.* The International Organization for Standardization (“ISO”) country code of the country in which the issuer is organized, and if different, the ISO country code of the country that corresponds to the country of investment or issuer, based on the concentrations of the risk and economic exposure of the investments. This information is submitted confidentially and will remain non-public;
- *Restricted security.* Whether the investment is a “restricted security;”
- *Fair value measurements.* Whether the investment is categorized by the fund as a Level 1, Level 2, or Level 3 fair value measurement in the fair value hierarchy under U.S. Generally Accepted Accounting Principles; and
- *Position-level liquidity classifications.* The liquidity classification of each portfolio investment classified in one of four categories — highly liquid, moderately liquid, less liquid, and illiquid.<sup>18</sup> This information is submitted confidentially and will remain non-public.
- ***Additional Position-Level Information for Debt Securities.*** A fund must report additional information concerning each debt security, including (1) the maturity date; (2) coupon (i.e. fixed, floating, variable or none and annualized rate); (3) whether the debt security is currently in default; (4) whether interest payments for the debt security are in arrears or coupon payments have been legally deferred; or (5) whether any portion of the interest is paid in kind.<sup>19</sup> A fund is required to disclose additional information for convertible securities, including (1) whether the conversion is mandatory or contingent; (2) information about the reference instrument into which the debt is convertible; (3) the conversion ratio; and (4) if applicable, the ratio of the change in the value of the option to

## SEC Issues Investment Company Reporting Modernization Rules

the change in the value of the asset into which the debt is convertible (“delta”). Delta for convertible securities is submitted confidentially and will remain non-public.

- **Additional Position-Level Information for Repurchase and Reverse Repurchase Agreements.** A fund must report additional information about any repurchase agreement (instances in which the fund is the cash lender and the recipient of the collateral) and reverse repurchase agreement (instances in which the fund is the cash borrower and poster of collateral), including (1) whether the transaction is cleared by a central counterparty (and, if so, the name of the central counterparty) or, if not, the name and LEI (if any) of the over-the-counter counterparty; (2) whether the agreement is tri-party; (3) the repurchase rate; (4) the maturity date; and (5) the principal amount, value, and category of investments that most closely resembles the collateral.<sup>20</sup>
- **Additional Position-Level Information for Derivatives.** For each derivative investment, a fund is required to report (1) the type of instrument (i.e., forward, future, option, swaption, swap (including total return swaps, credit default swaps and interest rate swaps, warrant or other, with a brief description if “other” is selected) and (2) the name and LEI (if any) of the counterparty (including a central counterparty). A fund must disclose the terms and conditions of each type of derivative investment sufficient for a user of financial information to understand the terms of the investment as follows:
  - *Options and warrants, including options on a derivative.* Provide (1) the type (put or call), (2) payoff profile (written or purchased), (3) a description of the reference instrument as set forth in “Reference instrument information” below, (4) number of shares or principal amount of the underlying reference instrument per contract, (5) exercise price or rate, (6) expiration date, (7) delta, and (8) unrealized appreciation or depreciation. Delta for options and warrants is submitted confidentially and will remain non-public;
  - *Futures and forwards (other than forward foreign currency contracts).* Provide (1) the payoff profile (long or short), (2) a description of the reference instrument as set forth in “Reference instrument information” below, (3) expiration date, (4) aggregate notional amount or contract value on the trade date, and (5) unrealized appreciation or depreciation;
  - *Forward foreign currency contracts and foreign currency swaps.* Provide (1) the amount and a description of the currency sold or purchased, (2) settlement date, and (3) unrealized appreciation or depreciation;
  - *Swaps (other than foreign exchange swaps).* Provide a description of (1) the terms of payments to be paid and received (including, as applicable, a description of the reference instrument as set forth in “Reference instrument information” below, financing rate, floating coupon rate, fixed coupon rate and payment frequency), (2) termination or maturity date, (3) upfront payments or receipts, (4) notional amount, and (5) unrealized appreciation or depreciation; and
  - *Other derivatives.* Provide a (1) description sufficient for a user of financial information to understand the nature and terms of the investment, (2) termination or maturity date (if any), (3) notional amount, (4) delta (if applicable)(non-public), and (5) unrealized appreciation or depreciation.
  - *Reference instrument information.*

## SEC Issues Investment Company Reporting Modernization Rules

- If the reference instrument is a derivative, a fund must indicate the type of derivative instrument and report all information required to be reported by Form N-PORT for that type;
- If the reference instrument is an index or custom basket, then:
  - If the index's or custom basket's components are (1) publicly available on a website and (2) updated no less than quarterly, a fund must identify the index and provide the index identifier, if any; and
  - If the index's or custom basket's components are not publicly available and updated at least quarterly, a fund must (1) describe the index or custom basket, if the notional amount of the derivative represents 1% or less of the NAV of a fund, (2) provide the name, identifier, number of shares or notional amount or contract value as of the trade date, and value of every component in the index or custom basket, if the notional amount of the derivative is more than 5% of the NAV of a fund, and (3) if the notional amount of the derivative is more than 1% but less than 5% of the NAV of a fund, report the component information described in (2) immediately above, but the fund may limit reporting to the 50 largest components and any other components where the notional value is over 1% of the notional value of the index or custom basket; and
- If the reference instrument is neither a derivative, index, nor a custom basket, the description of the reference instrument must include the name of the issuer, title of the issue, and the CUSIP number, ISIN, ticker, or other identifier.
- **Securities Lending.** A fund that engages in securities lending must report in its schedule of portfolio investments whether (1) any portion of an investment is on loan, and, if so, the value of the investment on loan; (2) any amount of an investment represents reinvestment of cash collateral received for loaned securities, and, if so, the value of the investment representing the cash collateral; and (3) any portion of an investment represents non-cash collateral that is treated as a fund asset, and, if so, the value of the investment representing the non-cash collateral.<sup>21</sup>

**Part D: Miscellaneous Securities.** As currently permitted by Regulation S-X, Form N-PORT permits a fund to report up to 5% of the total value of its portfolio on an aggregate basis as "miscellaneous securities," provided that securities comprising the category are not restricted, have not been held for more than one year prior to the date of the related balance sheet, and have not previously been reported by name to investors or to any exchange, set forth in any registration statement or application, or otherwise made available to the public. For reports filed by a fund for the last month of each fiscal quarter, if a fund reports miscellaneous securities, the fund also must provide information on a position-level basis for each investment in such category as if the investment were not a miscellaneous security. Position-level information on miscellaneous securities is submitted confidentially and will remain non-public.

**Part E: Explanatory Notes.** A fund will be permitted, but not required, to provide explanatory notes it believes would be helpful in understanding reported information, including any assumptions that the fund made in responding to an item. Explanatory notes related to non-public items are submitted confidentially and will remain non-public.

## SEC Issues Investment Company Reporting Modernization Rules

**Part F: Exhibits. Complete Schedule of Portfolio Holdings.** For Form N-PORT filings for the end of the first and third quarters of a fund's fiscal year, a fund is required to include an exhibit disclosing the fund's complete portfolio holdings as of the close of the period covered by the report, no later than 60 days after the end of the first and third quarters of the fund's fiscal year. This exhibit does not need to be submitted in XML format. The information in this exhibit is not required to be audited or certified and must be presented in accordance with the schedules set forth in §§ 210.12-12 to 12-14 of Regulation S-X. The schedule is a similar format to that used in Form N-Q and is intended to provide portfolio holdings information in a format that is familiar to investors.

**Information Submitted Confidentially.** Due to concerns about predatory trading practices and the potential that information otherwise may be exploited by non-investors, certain information is submitted confidentially and will remain non-public even if made on public filings of the form including:

- Information about individual investments reported in the aggregate as "miscellaneous securities;"
- Country of risk and economic exposure;
- Position-level liquidity classification information and a fund's highly liquid investment minimum;
- Delta for individual options, warrants, and convertible securities; and
- Explanatory notes related to non-public items.<sup>22</sup>

### **Rescission of Form N-Q and Amendment of Form N-CSR Certification**

**Requirements.** Because Form N-PORT encompasses all of the information previously required by Form N-Q, Form N-Q is rescinded effective August 1, 2019.<sup>23</sup> The rescission of Form N-Q eliminates the principal executive and financial officers' certifications pursuant to Rule 30a-2(a) under the 1940 Act and Section 302 of the Sarbanes-Oxley Act of 2002 ("Section 302 Certifications"). To close the certification gap created by the rescission of Form N-Q, the SEC amended the Section 302 Certifications filed with Form N-CSR for a fund's second and fourth fiscal quarters to cover the entire semi-annual period covered by those filings. The amendment to Form N-CSR will be effective on June 1, 2018 for Larger Funds, and June 1, 2019 for Smaller Funds.

### **New Form N-CEN**

Form N-CEN requires funds to provide much of the same general census-type information already contained in reports on Form N-SAR. The discussion of Form N-CEN below highlights additional disclosure requirements in Form N-CEN that differ materially from the information currently reported on Form N-SAR. All funds must complete Parts A and B and file any attachments required by Part G; funds organized as management companies, other than SBICs, must complete Part C; closed-end funds and SBICs must complete Part D; ETFs (including those organized as UITs) must complete Part E; and UITs must complete Part F.<sup>24</sup>

**Part A: General Information.** Both Forms N-SAR and N-CEN require information about the covered reporting period.

## SEC Issues Investment Company Reporting Modernization Rules

**Part B: Information about the Registrant.** In addition to the information required by Form N-SAR, Form N-CEN requires:

- A fund's CIK, LEI, public website (if any), and location of its books and records;<sup>25</sup>
- Information about a fund's directors and chief compliance officer, including the Central Registration Depository ("CRD") number for each director and chief compliance officer, if available;
- Information regarding financial support a fund has received from certain affiliated entities during the reporting period;<sup>26</sup>
- Whether a fund has relied on exemptive relief granted by the SEC from one or more provisions of the 1940 Act, the Securities Act of 1933, or the Securities Exchange Act of 1934 during the reporting period;
- Whether a fund's independent public accountant(s) identified any material weaknesses in its report on the fund's internal controls and whether the accountant's opinion on the audit of the fund's financial statements was qualified in any manner;
- With respect to a material change in valuation methods, in addition to the information currently required by Form N-SAR, the (1) asset type and (2) type of investment involved;
- Whether any NAV error resulted in payments to shareholders or reprocessing of shareholder accounts; and
- Whether any payments of dividends or distributions were made to shareholders requiring a written statement pursuant to Section 19(a) of the 1940 Act and Rule 19a-1 thereunder.

**Part C: Additional Questions for Management Investment Companies.** For each fund organized as a management company, other than a SBIC, in addition to information currently required by Form N-SAR, Part C of Form N-CEN requires:

- Specific information on the classes of an open-end fund, including identifying information for each share class outstanding and the number of classes authorized, added, and terminated during the reporting period;
- The type of fund;<sup>27</sup>
- If an index fund, whether the index the fund tracks is constructed by an affiliated person of the fund and, if so, whether the index is exclusively constructed for the fund. An index fund must further provide information regarding tracking difference and tracking error;<sup>28</sup>
- If a master-feeder fund, identifying information with respect to each registered and unregistered feeder fund, and, if a feeder fund, identifying information on its master fund;
- Whether the fund seeks to operate as a non-diversified investment company, as defined in Section 5(b)(2) of the 1940 Act;<sup>29</sup>
- Whether the fund invests in a CFC for purposes of investing in certain types of instruments, including commodities, and, if so, the name and LEI of the subsidiary;
- With respect to securities lending:
  - Whether it is authorized to engage in securities lending;

## SEC Issues Investment Company Reporting Modernization Rules

- Whether it loaned securities during the reporting period (and, if so, whether any borrower defaulted on its obligations which resulted in a fund having to liquidate pledged collateral or being otherwise adversely affected, and whether the fund is indemnified against borrower default, and, if so, whether it exercised this right);
- Information about each securities lending agent and cash collateral manager, including whether such agent(s) is a first or second-tier affiliate of the fund;
- Information about the types of payments made to securities lending agents and cash collateral managers; and
- The monthly average of the value of securities on loan and net income from securities lending activities;
- Whether the fund relied on certain rules under the 1940 Act during the reporting period. While Rules 10f-3, 2a-7, 12b-1 and 17a-7, are currently covered by Form N-SAR, N-CEN covers Rules 10f-3, 12d1-1, 15a-4, 17a-6, 17a-7, 17a-8, 17e-1, 22d-1, 23c-1, and 32a-4;
- Additional information regarding a fund's expense limitation arrangements, including whether any fees waived are subject to recoupment and whether any waived fees were recouped;
- Information on whether a fund service provider was hired or terminated during the reporting period and whether the service provider is affiliated with the fund or its adviser(s);
- Information on each person providing pricing services, whether it is affiliated with the fund or its adviser(s), and whether any pricing service was hired or terminated during the reporting period;
- Information on each committed and uncommitted line of credit, including the size of the line, the lender(s), whether the line is shared with other funds, whether the fund drew on the line of credit during the reporting period and, if so, the average dollar amount outstanding and number of days in use;<sup>30</sup>
- Whether the fund engaged in interfund lending or interfund borrowing during the reporting period and, if so, the average amount of the loan and the number of days in use;<sup>31</sup> and
- Whether the fund engaged in swing pricing during the reporting period, and, if so, the swing factor upper limit set by the fund.<sup>32</sup>

**Part D: Additional Questions for Closed-End Funds and SBICs.** Similar to Form N-SAR, closed-end funds and SBICs are required to report information on the securities they have issued, repurchases of securities during the reporting period, any default on long-term debt or dividends in arrears, and modification to instruments defining the rights of holders, although some of these disclosure items are simplified in Form N-CEN. Form N-CEN requires additional information relating to rights offerings and secondary offerings. In addition, closed-end funds must report advisory fees as a percentage of net assets and closed-end funds and SBICs must report net operating expenses (net of waivers) as a percentage of net assets. (Open-end funds currently report this information in XBRL format on Form N-1A.) SBICs also are required to provide information regarding investment advisers, transfer agents, and custodians in Part D, as they are not subject to Part C, where closed-end funds and open-end funds report this information.

## SEC Issues Investment Company Reporting Modernization Rules

**Part E: Additional Questions for ETFs and ETMFs.** Form N-CEN introduces a series of questions that elicit information unique to ETFs and ETMFs including:

- The exchange on which the fund is listed and the fund’s ticker symbol;
- Information about each authorized participant (“AP”), including (1) identifying information (e.g., full name, SEC file number, CRD number, and LEI), (2) the dollar value of fund shares purchased and redeemed by each AP during the reporting period, and (3) whether any AP was required to post collateral in connection with the purchase or redemption of fund shares during the reporting period;
- The number of fund shares required to form a creation unit;
- Based on the dollar value paid for each creation unit purchased by APs during the reporting period (1) the average percentage of the dollar value composed of cash, (2) the standard deviation of the percentage of the dollar value composed of cash, (3) the average percentage of the dollar value composed of non-cash assets and other positions exchanged in-kind, and (4) the standard deviation of the percentage of the dollar value composed of non-cash assets and other positions exchanged in-kind. Parallel information must be provided for the redemption of creation units;
- For creation units purchased by APs during the reporting period, the average transaction fee (1) charged in dollars per creation unit, (2) charged for one or more creation units on the same business day, and (3) charged as a percentage of the value of the creation unit. For those creation units purchased by APs that were fully or partially composed of cash, the average transaction fee (1) charged in dollars per creation unit, (2) charged for one or more creation units on the same business day, and (3) charged as a percentage of the value of the cash in the creation unit. Parallel information must be provided for the redemption of creation units;
- For a UIT that is an index fund, whether the index the fund tracks is constructed by an affiliated person of the fund and, if so, whether the index is exclusively constructed for the fund;
- Information regarding tracking difference and tracking error with respect to funds that are UITs; and<sup>33</sup>
- Whether the fund qualifies as an “in-kind ETF” for purposes of Rule 22e-4 under the 1940 Act.<sup>34</sup>

**Part F: Additional Questions for UITs.** Unlike Form N-SAR, which generally does not differentiate between UITs that are, and that are not, insurance company separate accounts, Form N-CEN makes this distinction and requires UITs that are insurance company separate accounts to make additional disclosure. A UIT that is an insurance company separate account is additionally required to disclose (1) its series identification number; (2) for each security with a contract identification number, the number of individual contracts in force at the end of the reporting period, and certain other census-type information, including information relating to Section 1035 exchanges;<sup>35</sup> and (3) whether the fund relied on Rules 6c-7 or 11a-2 under the 1940 Act during the reporting period. The Adopting Release notes that this information is either not currently filed with the SEC or is not filed in a structured format, thus providing the SEC with more data specific to these products and enhancing the SEC’s ability to monitor trends in the variable annuity and variable life insurance markets.

## SEC Issues Investment Company Reporting Modernization Rules

**Part G: Attachments.** Certain exhibits required on Form N-SAR are eliminated on Form N-CEN or will be reported elsewhere.<sup>36</sup> Form N-CEN adds one new exhibit: a fund (other than a MMF) must provide further information if it received financial support from certain affiliated entities. (Please see “Part B: Information About the Registrant” on page 13.) Exhibits to Form N-CEN do not need to be submitted in XML format.

**Form N-CSR Change Related to New Form N-CEN.** Form N-CEN eliminates the current Form N-SAR requirement to file a letter reporting a change to a fund’s independent registered public accountants. Effective June 1, 2018, this information must be filed as an exhibit to Form N-CSR. The Adopting Release explains that since Form N-CSR is filed semi-annually, the change will provide the staff more timely notice of any change to a fund’s independent registered public accountants.

**Items Required by Form N-SAR that are Eliminated by Form N-CEN.** Form N-CEN eliminates a number of Form N-SAR reporting items. In the Adopting Release, the SEC noted that these previously reported items are no longer needed, outdated in their current form, provide only minimal benefits to an SEC review and impose significant costs on funds, or otherwise are, or will be, reported on other SEC forms.

### Amendments to Regulation S-X

Regulation S-X contains the requirements for the presentation of fund financial statements in registration statements and shareholder reports. This section discusses some of the significant changes mandated by the Reporting Rules.<sup>37,38</sup>

**Derivatives Disclosure.** Rule 12-13 (Investments other than securities) is currently used by funds to report holdings in all derivatives, other than options. Because Rule 12-13 serves as a “catch all” category for investments that are not otherwise covered in the schedules to fund financial statements, funds report information on open futures contracts, open forward foreign currency contracts, and open swap contracts based on general disclosure conventions in the industry. The amendments to Regulation S-X redesignate current Rule 12-13 as new Rule 12-13D and add three separate new disclosure categories: Rules 12-13A (Open futures contracts), 12-13B (Open forward foreign currency contracts), and 12-13C (Open swap contracts). The new rules prescribe disclosure that is tailored to the specific derivative instrument.<sup>39</sup>

## SEC Issues Investment Company Reporting Modernization Rules

<u>Investment Type</u>	<u>Current Rule or Reporting Conventions</u>	<u>Material Changes Prescribed by New Rules 12-13A, 12-13B and 12-13C</u>
Open Futures Contracts	Rule 12-13 — a description of the contract (including the expiration date), the number of contracts held, and any unrealized appreciation or depreciation.	New Rule 12-13A — additionally disclose the name of the reference asset or index in the description of the contract, the notional amount, and the value of the contract.
Open Forward Foreign Currency Contracts	Rule 12-13 — a description of the contract (including a description of what is to be purchased and sold, and the settlement date), the amount to be purchased and sold on the settlement date, and any unrealized appreciation or depreciation.	New Rule 12-13B — additionally disclose the counterparty to the transaction.
Open Swap Contracts	Rule 12-13 — a description of the swap (including a description of what is to be paid and received, and the maturity date), the notional amount, and any unrealized appreciation or depreciation.	New Rule 12-13C — additionally disclose (1) the terms of the swap, (2) the counterparty to the transaction (except for exchange-traded and centrally cleared swaps), (3) the value, and (4) any upfront payments or receipts. <sup>40</sup> In the case of a swap contract with a reference instrument that is an index or basket of investments for which the components are publicly available on a website, or if the notional amount of the contract does not exceed 1% of the fund's NAV, each as of the balance sheet date, a fund must identify the index or basket. If the reference instrument is an index or basket that is not publicly available on a website, and the notional amount of the contract exceeds 1% of the fund's NAV as of the balance sheet date, the fund must identify the index or basket and separately list the 50 largest components and any other components where the notional value of the component exceeds 1% of the notional value of the index or basket. With respect to these separately listed components, the fund must disclose the (1) quantity held, (2) the value at the close of the period, (3) the percentage value when compared to the basket's net assets, and (4) a description of the underlying investment as would be required by Article 12 of Regulation S-X.
Other Investments	Rule 12-13 — a description of the investment, the balance at the close of period (quantity), and the value.	Redesignated as Rule 12-13D — the SEC revised the instructions to the rule to require a fund to (1) additionally categorize the schedule, as applicable, by the related industry, country or geographic region of the investment, and (2) disclose information sufficient to understand the nature and terms of the investment.

## SEC Issues Investment Company Reporting Modernization Rules

Rules 12-12B (Open option contracts written) and 12-12 (Investments in securities of unaffiliated issuers) are used by funds to report open option contracts. The SEC amended current disclosure requirements applicable to both written and purchased option contracts as described below:

<u>Investment Type</u>	<u>Current Rules</u>	<u>Material Changes Prescribed by the Amended Rules</u>
Open Option Contracts Written	Rule 12-12B — the name of the issuer, number of contracts (or number of shares subject to the option), exercise price, expiration date, and value.	Redesignated as Rule 12-13 — additionally disclose (1) a description of the contract (including a description of the underlying investment as would be required by Article 12 of Regulation S-X), (2) the counterparty to the transaction (except for exchange-traded and centrally cleared options), and (3) the contract’s notional amount. If the underlying investment is an index or basket of investments, a fund must provide the same type of information required for a swap contract with a reference instrument that is an index or basket of investments.
Open Option Contracts Purchased	Rule 12-12 — the name of issuer and title of issue, balance held at close of period (number of shares or principal amount of debt), and value.	Amended instructions to Rule 12-12 apply the same additional reporting requirements as apply under redesignated Rule 12-13 for option contracts written.

The Reporting Rules also rescind current Rule 6-10(a) that some funds relied on to make disclosure relating to derivatives in the notes to their financial statements. Rescission of Rule 6-10(a) means that funds must now prominently disclose details on their derivatives investments in the funds’ financial statements rather than in the notes to the financial statements.

***Investments in, and Advances to, Affiliates.*** Rule 12-14 prescribes disclosure requirements relating to investments in, and advances to, “affiliates” or companies in which the fund owns 5% or more of the outstanding voting securities. Amended Rule 12-14 removes the current requirement to disclose the amount of equity in net profit and loss for the reporting period. Instead, funds must disclose (1) the realized gain or loss, and (2) the net increase or decrease in unrealized appreciation or depreciation for each affiliated investment. Funds also must disclose (1) the aggregate of realized gain or loss, and (2) the aggregate increase or decrease in unrealized appreciation or depreciation for investments in affiliates not held at the close of the period.

***Other Amendments Relating to Schedules of Investments.*** The SEC also significantly amended the instructions to Rule 12-12 through 12-14. The revised instructions augment and standardize, where relevant, the information provided in the funds’ schedules to their financial statements. Significant additional disclosure mandated by the revised instructions to Rules 12-12 through 12-14 are set forth below:

## SEC Issues Investment Company Reporting Modernization Rules

	12-12 (Investments in securities of unaffiliated issuers)	12-12A (Investments—securities sold short)	12-12B (Summary schedule of investments in securities of unaffiliated issuers)	12-13 (Open option contracts written)	12-13A (Open futures contracts)	12-13B (Open forward foreign currency contracts)	12-13C (Open swap contracts)	12-13D (Investments other than those presented in other schedules)	12-14 (Investments in and advances to affiliates)
Categorize schedule as required by Instruction 2 to Rule 12-12. <sup>41</sup>		■							■
Provide subtotals for each category of investments, subdivided by <i>both</i> (1) type of investment and (2) industry, country, or geographic region, together with their percentage value compared to net assets. <sup>42</sup>	■	■	■					Note <sup>43</sup>	■
Identify each security the value of which was determined using significant unobservable inputs.	■	■	■	■	■	■	■	■	■
Indicate each investment that cannot be sold because of applicable restrictions or conditions. <sup>44</sup>	Note <sup>45</sup>		Note <sup>46</sup>	■	■	■	■	■	
Indicate the interest rate or preferential dividend rate and maturity date for certain debt instruments. <sup>47</sup>	■	■	■						■
Indicate each security held in connection with open put or call options, loans for short sales, or where any portion of an investment is on loan. <sup>48</sup>	■		■						■

## SEC Issues Investment Company Reporting Modernization Rules

***Other Amendments to the Form and Content of Financial Statements.*** The SEC adopted certain other amendments to the form and content of fund financial statements including, notably to:

- Remove the tax basis disclosure requirement from current Rules 12-12, 12-12C, and 12-13, and include it in Article 6 of Regulation S-X so that tax basis disclosure relates to the portfolio as a whole;
- Eliminate current Rule 6-04.4, which requires disclosure of “total investments” on a fund’s balance sheet under “Assets.” The SEC observed that investments in derivatives could potentially be presented under both assets and liabilities on the balance sheet making, for example, the totaling of a derivatives contract with unrealized appreciation and a liability balance for a separate derivative contract with unrealized depreciation potentially misleading;
- Amend instructions to Rule 6-07.1 to require funds to make a separate disclosure for other types of income (e.g., income from non-cash dividends or payment of in-kind interest) in the statement of operations, if all income of the particular type exceeds 5% of the fund’s investment income; and
- Amend Rules 6-07.7(a) and 6-07.7(c) (current Rule 6-07.7(d)) to conform statement of operations disclosures of (1) the net realized gains or losses from investments, and (2) the net increase or decrease in the unrealized appreciation or depreciation of investments to reflect the updated derivatives disclosure requirements.

### Amendments to Forms Relating to Securities Lending Activities

According to the Adopting Release, in order to provide investors with more information on funds’ securities lending activities and the impact of securities lending on fund performance, the SEC adopted amendments to certain forms to require standardized disclosure relating to these activities in SAls (Forms N-1A and N-3) and, with respect to closed-end funds only, shareholder reports (Form N-CSR).<sup>49</sup> A fund must disclose (1) gross income (including income from cash collateral reinvestment) and net income from securities lending activities and related services; (2) fees and/or compensation paid by it in connection with securities lending, in the aggregate and broken out by enumerated categories; and (3) a description of the services provided to the fund by the securities lending agent during the most recent fiscal year. Notably, the SEC was persuaded by commenters that public disclosure of specific fee arrangements with securities lending agents (including any revenue sharing split), a proposed requirement, was unnecessary.

### Website Transmission of Shareholder Reports

As outlined in the Proposing Release, proposed Rule 30e-3 would have permitted funds to satisfy their shareholder report transmission requirements by making such reports accessible on a website, if certain conditions were met, unless a shareholder elects to receive paper copies via mail. The SEC received over 900 comment letters. Comments ranged from support for the proposal as an efficient means by which shareholders could access shareholder reports and other information to concerns about certain demographics no longer having access to these reports and some investors’ continued preference for printed materials. Conflicting comments were also received on whether the measure would result in actual cost savings for funds.<sup>50</sup> The Adopting Release indicates that the SEC intends to

## SEC Issues Investment Company Reporting Modernization Rules

continue studying this proposed rule and, as noted earlier, Chair White has directed the staff to prepare a recommendation for the SEC's consideration by year end. However, given the SEC's other rulemaking priorities, and concern expressed by at least one SEC Commissioner as to the proposed rule's unintended effect on shareholder communications, it appears uncertain whether the proposal will be adopted in the near term.

<sup>1</sup> Investment Company Reporting Modernization, Release Nos. 33-10231; 34-79095; IC-32314 (Oct. 13, 2016) ("Adopting Release") <https://www.sec.gov/rules/final/2016/33-10231.pdf>.

<sup>2</sup> We use "funds" to mean all registered investment companies other than face-amount certificate companies, except as otherwise noted.

<sup>3</sup> Mary Jo White, Chair, SEC, Statement at Open Meeting: Modernizing and Enhancing Investment Company and Investment Adviser Reporting (Oct. 13, 2016) <https://www.sec.gov/news/statement/white-statement-open-meeting-101316.html>.

<sup>4</sup> Currently, most funds must report their portfolio holdings on Form N-Q within 60 days after the close of their first and third fiscal quarters and in their annual and semi-annual reports within 60 days after the close of their second and fourth fiscal quarters. Funds' annual and semi-annual reports must be filed on Form N-CSR within 10 days after the transmission of such reports to shareholders.

<sup>5</sup> Liquidity Risk Management Programs, Release Nos. 33-10233; IC-32315 (Oct. 13, 2016) <https://www.sec.gov/rules/final/2016/33-10233.pdf>.

<sup>6</sup> Investment Company Swing Pricing, Release Nos. 33-10234; IC-32316 (Oct. 13, 2016) <https://www.sec.gov/rules/final/2016/33-10234.pdf>.

<sup>7</sup> New disclosure required in Form N-1A and by Regulation S-X resulting from adoption of the liquidity risk management and swing pricing rules are not addressed in this Client Alert. Please see our Client Alert on the SEC's liquidity risk management and swing pricing rules for information on these disclosure requirements.

<sup>8</sup> Investment Company Reporting Modernization, Release Nos. 33-9776; 34-75002; IC-31610 (May 20, 2015) ("Proposing Release") <https://www.sec.gov/rules/proposed/2015/33-9776.pdf>.

<sup>9</sup> The LEI is a unique identifier generally associated with a single corporate entity and is intended to provide a uniform international standard for identifying counterparties to a transaction. LEIs are assigned by utilities recognized by the Global LEI Regulatory Oversight Committee or accredited by the Global LEI Foundation.

<sup>10</sup> LEIs currently may be obtained from the Global Markets Entity Identifier Utility for a one-time fee of \$219 plus \$199 per year in annual maintenance costs and fees.

<sup>11</sup> The SEC clarified in the Adopting Release that in calculating notional debt exposure, a top-tier fund in a fund-of-funds structure would generally not look through to its underlying funds' holdings.

<sup>12</sup> The average value of a fund's debt securities, or derivatives that provide exposure to debt securities or interest rates, is calculated as the sum of the absolute values of: (1) the value of each debt security; (2) the notional amount of each swap for which the underlying reference asset(s) is a debt security or an interest rate; (3) the notional value of each futures contract for which the underlying reference asset(s) is a debt security or an interest rate; and (4) the delta-adjusted notional amount of any option for which the underlying reference asset(s) is an asset described in (1), (2) or (3) above.

<sup>13</sup> The final rule increases the notional debt exposure threshold from 20% of a fund's NAV, as originally proposed, to 25% and allows a fund to calculate this threshold based on the three-month average of the fund's notional debt exposure, rather than, as originally proposed, the fund's notional debt exposure as of the reporting date. The final rule also provides that risk metrics calculations are required only for currencies with a value of 1% or more of a fund's NAV, a *de minimis* threshold that did not appear in the rule as proposed.

<sup>14</sup> When the swing pricing rule becomes effective, return information must also reflect swing pricing for funds that elect to swing price. Please see our Client Alert on the SEC's new liquidity risk management and swing pricing rules for more information.

<sup>15</sup> The compliance date for disclosure of Liquidity-Related Information is later than the compliance date for Larger Funds to file Form N-PORT. Please see "*Compliance Dates*" on page 5.

<sup>16</sup> Funds may report information on Form N-PORT as of the last business day, or last calendar day, of the month.

<sup>17</sup> Portfolio holdings information filed under Part F: Exhibits must be presented in accordance with Regulation S-X which requires trade date reporting (T+0).

<sup>18</sup> See Note 15.

<sup>19</sup> A fund need not disclose interest paid in-kind under this item if the fund has the option of electing in-kind payments and has elected to be paid in-kind.

<sup>20</sup> Such information is comparable to current repurchase agreement disclosure made by MMFs on Form N-MFP.

<sup>21</sup> Form N-PORT requires a fund to report the aggregate principal amount and aggregate value of each type of non-cash collateral that is not included in the fund's schedule of investments (because it is not treated as a fund asset). If the fund treats non-cash collateral as a fund asset, the fund must identify such assets on an investment-level basis.

## SEC Issues Investment Company Reporting Modernization Rules

<sup>22</sup> The general instructions to Form N-PORT provide that information reported on Form N-PORT for the first and second months of a fund's fiscal quarter that is identifiable to any particular fund or adviser, and any information that is submitted confidentially that is identifiable to any particular fund or adviser will not be made public. The SEC stated, however, that it could issue analyses or reports that are based on aggregated, non-identifying Form N-PORT data, which would otherwise be non-public.

<sup>23</sup> The Adopting Release states that the rescission of Form N-Q becomes effective two months after the compliance date for Form N-PORT for Smaller Funds to allow these funds adequate time to satisfy Form N-Q's 60 day filing requirement for their last Form N-Q for the reporting period preceding their first filing on Form N-PORT.

<sup>24</sup> Funds that are registered on Form N-3 must also complete certain items in Part F as directed by Item B.6.c.i of Form N-CEN.

<sup>25</sup> To avoid the filing of duplicative information, the SEC amended Forms N-1A, N-2, N-3, N-4 and N-6 to exempt funds from the books and records disclosure requirements on those registration forms if the information is reported on Form N-CEN.

<sup>26</sup> These include any affiliated person, promoter, or principal underwriter of the fund, or an affiliated person of such a person. The form clarifies that routine waiver of fees or reimbursement of a fund's expenses would not constitute financial support and lists other exclusions from the meaning of financial support.

<sup>27</sup> A fund must self identify as an: (1) ETF or ETMF; (2) index fund; (3) fund seeking to achieve performance results that correlate with a benchmark (i.e., a multiple of a benchmark, the inverse of a benchmark, or a multiple of the inverse of a benchmark); (4) interval fund; (5) fund of funds; (6) master-feeder fund; (7) MMF; (8) target date fund; or (9) underlying fund to a variable annuity or variable life insurance contract.

<sup>28</sup> An index fund must provide (1) the annualized difference, before and after fees and expenses, between the fund's total return and the index's return during the reporting period; and (2) the annualized standard deviation, before and after fees and expenses, of the daily difference between the fund's total return and the index's return during the reporting period. The SEC stated in the Adopting Release that in providing this information, it expects an index fund that is an ETF to use its NAV-based total return, rather than market-based total return.

<sup>29</sup> This item differs from the information requested on Form N-SAR, which requires a fund to report whether it was a diversified investment company at any time during the period or at the end of the reporting period. The Adopting Release explains that the change is intended to capture those funds that seek to operate as non-diversified funds, even if they meet the definition of a diversified fund at the end of a reporting period.

<sup>30</sup> The compliance date for disclosure of Lending/Borrowing Information is later than the compliance date to file Form N-CEN. Please see "*Compliance Dates*" on page 5.

<sup>31</sup> See Note 30.

<sup>32</sup> The compliance date for disclosure of Swing Pricing Information is later than the compliance date to file Form N-CEN. Please see "*Compliance Dates*" on page 5.

<sup>33</sup> Like index funds, ETFs and ETMFs must provide (1) the annualized difference, before and after fees and expenses, between the fund's total return and the index's return during the reporting period; and (2) the annualized standard deviation, before and after fees and expenses, of the daily difference between the fund's total return and the index's return during the reporting period.

<sup>34</sup> The compliance date for this disclosure item is the same as for Liquidity-Related Information. Please see "*Compliance Dates*" on page 5.

<sup>35</sup> This information includes: (1) name of the security, (2) contract identification number, (3) total assets attributable to the security, (4) number of contracts sold, (5) gross premiums received, (6) gross premiums received pursuant to Section 1035 exchanges, (7) number of contracts affected in connection with premiums paid pursuant to Section 1035 exchanges, (8) amount of contract value redeemed, (9) amount of contract value redeemed pursuant to Section 1035 redemptions, and (10) number of contracts affected in connection with contract value redeemed pursuant to Section 1035 exchanges.

<sup>36</sup> These include exhibits relating to policies with respect to securities investments, matters submitted to a vote of security holders, changes in security for debt, default and arrears on senior securities, changes in control, terms of new or amended securities, revaluation of assets or restatement of capital share account, changes in a fund's independent registered public accountants, mergers, transactions effected pursuant to Rule 10f-3 under the 1940 Act, and actions required to be reported pursuant to Rule 2a-7 under the 1940 Act.

<sup>37</sup> For purposes of this discussion of Regulation S-X, references to "funds" also include business development companies.

<sup>38</sup> The amendments to Regulation S-X renumber certain rules in Article 12 and break out current Rule 12-13 into four separate subsections. The table below sets forth the current and amended numbering schemes:

<u>Current rules</u>	<u>Amended rules</u>
12-12 (Investments in securities of unaffiliated issuers)	Same
12-12A (Investments—securities sold short)	Same
12-12B (Open option contracts written)	12-13 (Open option contracts written)

## SEC Issues Investment Company Reporting Modernization Rules

12-12C (Summary schedule of investments in securities of unaffiliated issuers)	12-12B (Summary schedule of investments in securities of unaffiliated issuers)
12-13 (Investments other than securities)	12-12C (Removed and reserved) 12-13A (Open futures contracts) 12-13B (Open forward foreign currency contracts) 12-13C (Open swap contracts) 12-13D (Investments other than those presented in §§ 210.12-12, 12-12A, 12-12B, 12-13, 12-13A, 12-13B, and 12-13C)
12-14 (Investments in and advances to affiliates)	Same

<sup>39</sup> In conjunction with the expanded derivatives disclosure requirements, the SEC eliminated the exception in Schedule II of current Rule 6-10 which does not require reporting under current Rule 12-13 if the investments, at both the beginning and end of the period, amount to 1% or less of the value of a fund's total investments. In eliminating the exception, the SEC reasoned that a fund may have significant notional amounts in its portfolio that could be valued at 1% or less of the value of its total investments.

<sup>40</sup> Instructions to new Rule 12-13C state that the description provided should be sufficient to understand the terms of payments to be received and paid and outlines disclosure required for credit default swaps, interest rate swaps, and total return swaps.

<sup>41</sup> The proposed rule would have required a fund to categorize investments in this schedule by (1) type of investment, (2) the related industry, and (3) the related country or geographic region. The SEC ultimately did not require categorization by both industry and country or geographic region, agreeing with commenters that such presentation may be confusing to investors.

<sup>42</sup> Currently, funds are required to provide subtotals by a single type of group such as business grouping or instrument; industry, country or geographic region; or not at all.

<sup>43</sup> Rule 12-13D requires a fund to categorize the schedule by type of investment and, as applicable, the related industry, country, or geographic region rather than requiring subtotals for each category.

<sup>44</sup> The instructions to Rule 12-13 currently require that a fund identify each investment that is not "readily marketable," which is defined as including investments for which there is no independent publicly quoted market and investments which cannot be sold because of restrictions or conditions applicable to the investment.

<sup>45</sup> Rule 12-12 already requires a fund to identify restricted securities.

<sup>46</sup> Rule 12-12B already requires a fund to identify restricted securities.

<sup>47</sup> For variable rate securities, a fund must describe the reference rate and spread and (1) the end of period interest rate or (2) disclose the end of period reference rate for each reference rate described in the schedule. For payment in kind securities, a fund must disclose the rate paid in kind.

<sup>48</sup> For Rules 12-12 and 12-12B, the amended instructions add the requirement to indicate whether any portion of an investment is on loan. For Rule 12-14, this instruction is a new requirement.

<sup>49</sup> This disclosure was originally proposed to be included in a fund's financial statements. However, the SEC moved the disclosure in response to concerns from commenters, including concerns about the costs and length of such disclosure.

<sup>50</sup> In August 2016, the New York Stock Exchange filed proposed rules that would limit the processing fee rates that brokers could charge funds for online delivery of shareholder reports as contemplated by proposed Rule 30e-3. This development ameliorated concerns that Rule 30e-3 would not result in the intended cost savings to funds.

### Authors:

**Yoon Y. Choo**  
yoon.choo@klgates.com  
+1.202.778.9340

**Lucie G. Enns**  
lucie.enns@klgates.com  
+1.202.778.9329

**Alyssa B. King**  
alyssa.king@klgates.com  
+1.202.778.9478

## SEC Issues Investment Company Reporting Modernization Rules

Anchorage Austin Beijing Berlin Boston Brisbane Brussels Charleston Charlotte Chicago Dallas Doha Dubai  
Fort Worth Frankfurt Harrisburg Hong Kong Houston London Los Angeles Melbourne Miami Milan Munich Newark New York  
Orange County Palo Alto Paris Perth Pittsburgh Portland Raleigh Research Triangle Park San Francisco São Paulo Seattle  
Seoul Shanghai Singapore Sydney Taipei Tokyo Warsaw Washington, D.C. Wilmington

K&L Gates comprises approximately 2,000 lawyers globally who practice in fully integrated offices located on five continents. The firm represents leading multinational corporations, growth and middle-market companies, capital markets participants and entrepreneurs in every major industry group as well as public sector entities, educational institutions, philanthropic organizations and individuals. For more information about K&L Gates or its locations, practices and registrations, visit [www.klgates.com](http://www.klgates.com).

This publication is for informational purposes and does not contain or convey legal advice. The information herein should not be used or relied upon in regard to any particular facts or circumstances without first consulting a lawyer.

© 2016 K&L Gates LLP. All Rights Reserved.