SEC Proposes Rules to Modernize and Enhance Information Reported by Investment Companies and Investment Advisers

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On May 20, 2015, the Securities and Exchange Commission (the "**SEC**") proposed rules, forms and amendments under both the Investment Company Act of 1940, as amended (the "**Investment Company Act**") and the Investment Advisers Act of 1940, as amended (the "**Advisers Act**") to strengthen and update reporting and disclosure by registered investment companies ("**RICs**") and investment advisers.

According to the SEC, proposals made under the Investment Company Act would enhance data reporting for mutual funds, exchange-traded funds ("**ETFs**") and other RICs. The proposals consist of the following principal reforms:

- Requiring RICs, other than money market funds, to file a new monthly portfolio reporting form, Form N-PORT, that would provide portfolio-wide and position-level holdings data to the SEC on a monthly basis.
- Amending Regulation S-X to require enhanced and standardized disclosures in the financial statements that are required in RICs' registration statements and shareholder reports.
- Requiring RICs to file a new annual reporting form, Form N-CEN, that would provide certain census-type information to the SEC and would replace Form N-SAR, the form currently used to report RIC census information.
- Permitting mutual funds and other RICs to satisfy transmission requirements by making reports accessible to shareholders on their website.

The information in each of the Forms N-PORT and N-CEN would be reported in a structured data format, similar to reporting currently required for money market funds through Form N-MFP and certain private funds through Form PF.

Proposals made under the Advisers Act consist of the following principal reforms:

- Amending Form ADV to require investment advisers to provide additional information, including regarding the use of borrowings and derivatives in separately managed accounts, branch office operations and use of social media (among other things).
- Permitting "umbrella registration" filing arrangements currently outlined in SEC staff guidance, under which private fund adviser entities operating a single advisory business can register together using a single Form ADV.

- Amending Rule 204-2 under the Advisers Act to require investment advisers to maintain records of the calculation of performance information that is distributed to any person, as opposed to the current rule that requires investment advisers to maintain performance information only when it is distributed to 10 or more persons.

This Client Memorandum summarizes the details of the proposed reforms. Comments on the proposed rules are due by August 11, 2015.

Proposals and Amendments Relating to the Investment Company Act

Portfolio Reporting on Form N-PORT and Related Amendments to Regulation S-X

Proposed Form N-PORT

Management investment companies (other than small business investment companies ("**SBICs**")) are currently required to submit quarterly reports detailing their complete portfolio holdings to the SEC on Form N-Q and Form N-CSR.

The proposed rules would rescind Form N-Q and adopt a new reporting form, Form N-PORT, which would be filed by all RICs and ETFs organized as unit investment trusts ("**UITs**"), other than money market funds and SBICs. Proposed Form N-PORT would be filed with the SEC on a monthly basis, and the report filed for every third month of a RIC's fiscal quarter would be available to the public beginning 60 days after the end of such fiscal quarter.

Reports detailing investment companies' portfolio holdings would be submitted on proposed Form N-PORT in Extensible Markup Language ("**XML**") in a structured data format. According to the SEC, the structured data format would enable the SEC, investors and other potential users to more easily aggregate and analyze portfolio holdings information. The proposed Form N-PORT would require certain additional information concerning a RIC's portfolio holdings as well as information regarding: (i) the RIC's derivative usage, (ii) certain risk metrics in order to measure the RIC's exposure to changes in interest rates, credit spreads and asset prices, (iii) information about certain activities of the RIC, such as securities lending and repurchase agreements and (iv) information to assist the SEC in assessing the liquidity risk of the RIC. The SEC stated that the information required by proposed Form N-PORT would assist it in both (i) better understanding various risks in the industry as a whole (which would in turn help inform its regulation of the industry) and (ii) examining, enforcing and monitoring RICs. In addition to general information such as the name and legal entity identifier ("**LEI**") of the RIC, proposed Form N-PORT would require disclosure on the following items, among others:

- *Assets and Liabilities*. RICs would report total assets, total liabilities and net assets. Separately, RICs would report the amount of certain assets, including the aggregate value of any "miscellaneous securities" held in their portfolios. The SEC proposed that RICs further report such miscellaneous securities on an investment-by-investment basis, although such investment-specific information would be nonpublic and used solely by the SEC. In addition, RICs would report any assets invested in a controlled foreign corporation ("**CFC**") and the underlying investments held through such CFC, rather than just the investment in the CFC itself. RICs would also report the amount of certain liabilities, including borrowings attributable to amounts payable on bonds, notes, and similar debt; payables for investments purchased either on a delayed delivery or on a standby commitment basis; and liquidation preference of outstanding preferred stock issued by the RIC.
- *Portfolio-Level Risk Metrics*. RICs would report quantitative measurements of certain risk metrics beyond more narrative disclosures in the registration statement, including risk measures at the investment level for options and convertible bonds. Specifically, certain RICs that invest in debt instruments or derivatives exposed to debt instruments or interest rates would have to provide a portfolio-level calculation of duration and spread duration across the applicable maturities in the portfolio.
- *Securities Lending*. RICs would be required to report new information not previously required on Form N-SAR, including the extent to which they lend their portfolio securities, the fees and revenues received from such activities, and for each of their securities lending counterparties as of the reporting date, the full name and LEI of the counterparty (if any), as well as the aggregate value of all securities on loan to such counterparty.

- *Return Information*. RICs would be required to provide monthly total returns for each of the preceding three months. These returns would be calculated using the same standardized formulas used in the performance table contained in the risk-return summary of the RIC's prospectus and in its sales materials. RICs would also be obligated to report, for each of the preceding three months, monthly net realized gain or loss and net change in unrealized appreciation or depreciation attributable to both (i) derivatives in each of the following categories: commodity contracts, credit contracts, equity contracts, foreign exchange contracts, interest rate contracts and other derivatives contracts, and (ii) investments other than derivatives.
- *Flow Information*. RICs would be required to report, for each of the preceding three months, the total net asset value of: (i) shares sold (including exchanges but excluding reinvestment of dividends and distributions); (ii) shares sold in connection with reinvestments of dividends and distributions; and (iii) shares redeemed or repurchased (including exchanges). This information is similar to what is currently reported on Form N-SAR and would be generally subject to the same guidelines.
- *Schedule of Portfolio Investments, including Terms of Derivatives*. RICs would be required to report certain basic information about each investment they hold, including (among other things) the name of the issuer, the asset type, the payoff profile of the investment, the amount of each investment, whether the investment is a restricted security or an illiquid asset, and the investment's categorization as a Level 1, Level 2 or Level 3 fair value measurement under U.S. Generally Accepted Accounting Principles. Debt securities, convertible securities and repurchase and reverse repurchase agreements would be subject to additional disclosure requirements. With respect to derivatives, RICs would be required to disclose certain characteristics and terms of each derivative contract in the RIC's portfolio, including the category of the contract (e.g., forward, future, option) and identifying information of the counterparty. Further, RICs would be required to disclose the terms and conditions of each derivative investment. For example, in the case of an option or warrant, the SEC states that RICs would report the type, payoff profile, exercise price or rate, expiration date and the unrealized appreciation or depreciation of the option or warrant, among other things. In the case of derivatives whose underlying assets are indices (or another basket of assets), RICs would need to disclose the identity of the index and potentially further information. The SEC also emphasized that for options, RICs would be required to report the "delta" of such option, which is the ratio of change in the value of the option to the change in the value of the reference instrument.
- *Securities on Loan and Cash Collateral Reinvestment*. RICs would be required to report, for each investment, information about securities on loan and the reinvestment of cash collateral that secured the loans.

Consistent with current practice, RICs would have until 60 days after the end of their second and fourth fiscal quarters to transmit reports to shareholders containing portfolio holdings schedules. RICs would have 30 days after the end of their first and third fiscal quarters to file reports on proposed Form N-PORT that would include portfolio holdings schedules.

Amendments to Regulation S-X Regarding Reporting of RIC Financial Statements

Regulation S-X generally prescribes the form and content of the financial statements required in RICs' registration statements and shareholder reports. Currently, Regulation S-X does not prescribe specific disclosure requirements for most types of derivatives, including swaps, futures and forwards. The SEC is proposing amendments to Regulation S-X that would standardize derivatives disclosures in financial statements in a way that conforms to the requirements on proposed Form N-PORT. These changes include additional required information, such as the assets underlying swap and option contracts, as well as changes in form and content, such as more prominent placement of disclosure on derivatives in the financial statements themselves, rather than in the notes to the financial statements. More specifically, the proposed amendments would require new schedules for open futures contracts, open forward foreign currency contracts and open swap contracts, as well as modifying the current disclosure of written option contracts by requiring a description of the contract, the counterparty to the transaction and the contract's notional amount.

Because proposed Form N-PORT is not primarily designed for individual investors, the proposed amendments to Regulation S-X would require disclosures concerning the RIC's investments in derivatives, as well as other disclosures related to liquidity and pricing of investments, in the financial statements that are provided to investors.

Census Reporting on Form N-CEN

The SEC currently requires management investment companies and UITs to report census-type information semi-annually and annually, respectively, on Form N-SAR. The SEC is proposing to rescind Form N-SAR and replace it with Form N-CEN, a new form on which all RICs, except face amount certificate companies, would report census-type information on an annual basis using a structured XML format. The information and form attachments would be similar to those currently required on Form N-SAR, including background information about the RIC and its classification, as well as the identity of its principal underwriters and its officers and directors.

Proposed Form N-CEN would include a new item requiring reporting as to whether the RIC relied on exemptions granted by the SEC from one or more provisions of the Investment Company Act, the Securities Act of 1933, as amended (the "**Securities Act**") or the Securities Exchange Act of 1934, as amended (the "**Exchange Act**") during the reporting period. Among other additional items required, the proposed Form N-CEN would include an item relating to whether an open-end fund made any payments to shareholders or reprocessed shareholder accounts as a result of an NAV error.

Parts A and B of proposed Form N-CEN would collect certain background information about the filing RIC: Part A would require a RIC to report the fiscal-year end date and indicate if a report covers a period of less than 12 months, while Part B would require a RIC to report certain background and other identifying information (including its classification and whether it is part of a family of investment companies, among other matters).

With respect to RICs that are management investment companies (other than SBICs), Part C of proposed Form N-CEN would require, among other things, (i) information on classes of shares, (ii) information concerning investments in CFCs, (iii) additional information regarding their securities lending activities, including whether the RIC is authorized to engage in securities lending transactions and whether it loaned securities during the reporting period, (iv) reporting on whether the RIC relied on certain rules under the Investment Company Act, (v) information regarding expense limitations, and (vi) information on the RIC's service providers. With respect to a RIC's securities lending activities, proposed Form N-CEN would further require information about the fees associated with securities lending activity and information about the management company's relationship with securities-lending-related service providers. Specifically, disclosure would be required as to whether any borrower of securities had defaulted on its obligations to the management company, and whether the RIC is indemnified against borrower default.

RICs that are closed-end funds and SBICs would be required to report, on Part D of proposed Form N-CEN, information on the securities they have issued, as well as information relating to rights offerings, secondary offerings and repurchases of such RIC's securities, among other things.

Part E of proposed Form N-CEN would require information specific to ETFs. Among other additional reporting requirements, ETFs would be required to report additional information regarding their authorized participants, including the name of each, as well as the dollar value of the ETF shares that authorized participants purchased and redeemed from the ETF during the reporting period. ETFs would also be required to report summary information about the characteristics of creation units (the large blocks of shares that authorized participants may purchase from or redeem to the ETF). ETFs would be required to report the total value of creation units that were either purchased by authorized participants in exchange for portfolio securities on an in-kind basis, redeemed primarily on an in-kind basis, purchased in exchange for cash, or redeemed primarily on a cash basis as well as the applicable transactional fees.

Part F of proposed Form N-CEN would require information specific to UITs. Along with certain identifying information, proposed Form N-CEN would require information on whether a UIT is a separate account of an insurance company, along with requiring information to be reported by separate accounts offering variable annuity and variable life insurance contracts.

Proposed Form N-CEN would also eliminate a number of Form N-SAR items where the information is (or would be, under the proposed reforms) reported elsewhere.

Website Transmission of Shareholder Reports

Currently, RICs are generally required to transmit reports to shareholders on a semi-annual basis. Such reports have traditionally been in the form of mailed paper copies, although the SEC has noted that many RICs voluntarily make them additionally available on their websites. Under the new proposed Rule 30e-3 under the Investment

Company Act, RICs would be permitted, but not required, to satisfy shareholder report transmission requirements by making materials publicly accessible on a specified website.

In order to rely on Rule 30e-3, RICs would have to make the materials publicly accessible free of charge at a website address specified in a notice to shareholders. In addition, RICs would need to offer shareholders the option to receive paper copies of shareholder reports, and electronic transmission of shareholder reports to any particular shareholder would be permitted only if such shareholder had previously consented to electronic transmission. Proposed Rule 30e-3 would also require RICs (or their financial intermediaries) to send, at no cost to the requestor, a paper copy of any shareholder reports to any person requesting such a copy.

RICs that do not maintain websites or otherwise wish to transmit reports in paper would continue to satisfy transmission requirements.

Compliance Dates

Form N-PORT and Rescission of Form N-Q

The SEC has indicated that if the foregoing proposals are adopted, RICs will be required to adhere to a tiered set of compliance dates based on asset size, as summarized below:

- Larger entities (RICs that, together with other RICs in the same related group, have net assets of $1 billion or more) must comply with the new reporting requirements 18 months after the effective date.
- Smaller entities (RICs that, together with other RICs in the same related group, have net assets of less than $1 billion) must comply with the new reporting requirements 30 months after the effective date.

Form N-CEN and Rescission of Form N-SAR

The SEC has proposed a compliance date of 18 months after the effective date to comply with the new reporting requirements on proposed Form N-CEN.

Website Transmission of Shareholder Reports

As reliance on proposed Rule 30e-3 is optional, no compliance period is needed and RICs would be able to rely on the rule immediately following the effective date.

Regulation S-X and Related Amendments

The SEC has proposed an 8-month compliance period and has indicated that the shorter compliance period is due to the fact that these proposed amendments are largely consistent with existing RIC disclosure practices.

- **See a copy of the release relating to Investment Company Reporting Modernization**

Amendments to Form ADV and Advisers Act Rules

Amendments to Form ADV

The SEC is proposing to amend Form ADV in order to (i) provide additional information to the SEC about registered investment advisers, including information about separately managed accounts managed by such advisers, and (ii) allow private fund adviser entities operating a single advisory business to register using a single Form ADV – a concept generally referred to as "umbrella registration." In addition to the proposed amendments to Form ADV discussed below, the SEC proposed a number of clarifying and technical amendments to Form ADV designed to make the filing process clearer for investment advisers.

Information Regarding Separately Managed Accounts

According to the SEC, the SEC currently collects limited specific information regarding separately managed accounts (i.e., advisory accounts that are not pooled investment vehicles). The proposed amendments to Form ADV

would require advisers to provide more detailed information on the separately managed accounts that they advise on an aggregated basis.

First, advisers would need to report the percentage of separately managed account "regulatory assets under management" invested in ten broad asset categories including exchange-traded equity securities and U.S. government or agency bonds. Second, advisers with at least $150 million in assets under management attributable to separately managed accounts would be required to report information on the use of borrowings and derivatives in those accounts. Advisers with at least $150 million but less than $10 billion in assets under management attributable to separately managed accounts would need to report the number of accounts that correspond to certain categories of gross notional exposures and the weighted average amount of borrowings (as a percentage of net asset value) in those accounts. Advisers with at least $10 billion in assets under management attributable to separately managed accounts would also report the weighted average gross notional value of derivatives (as a percentage of the net asset value) in each of six different categories of derivatives. This information would be similar to that currently required to be reported by advisers on Form PF with respect private funds. Third, advisers would need to identify any custodians that account for at least ten percent of separately managed account regulatory assets under management, along with the percentage of such assets held at such custodian.

Advisers would be required to report this information annually; for advisers with at least $10 billion in assets under management attributable to separately managed accounts, data on both a mid-year and year-end basis would need to be reported as part of their annual filing. The SEC has requested comment on whether it should also require advisers to report information about the use of securities lending and repurchase agreements in separately managed accounts.

Additional Information Regarding Investment Advisers

The SEC also proposed amendments to Form ADV to include several new questions relating to (i) identifying information, (ii) social media and (iii) the offices of the adviser. Under the proposed amendments, advisers would be required to provide a CIK Number if it had one assigned. In addition, advisers would be required to report on whether it utilized websites for social media platforms such as Twitter, Facebook and LinkedIn. Advisers would also have to report certain contact and census information about their 25 largest offices in terms of number of employees (rather than their largest five offices, as is currently required).

The amended Form ADV would also require advisers to provide the exact number, rather than approximate ranges, of the number of advisory clients, the types of advisory clients and regulatory assets under management attributable to client types. The SEC proposed to amend Item 5 of Part 1A to require advisers to report additional information concerning wrap fee programs, including the total amount of regulatory assets under management attributable to the adviser acting as a sponsor and/or portfolio manager of such a program. Further, the amended Form ADV would require advisers to provide identifying numbers in several questions relating to an adviser's financial industry affiliations and the private funds it managed, as well as reporting the percentage of a private fund owned by "qualified clients," as defined in Rule 205-3 under the Advisers Act.

The amended Form ADV would also require information on third-party providers of compliance officer services. Advisers would be asked to report whether the chief compliance officer is compensated or employed by any person other than the adviser, and if yes, the name and IRS Employer Identification Number (if any) of that other person. The SEC has also requested comment on whether it should require disclosure of information regarding advisers' use of third-party compliance auditors.

Umbrella Registration

The SEC proposed amendments to Part 1A of Form ADV to codify the concept of "umbrella registration," whereby a group of private fund advisers that operate as a single business may file a single Form ADV. Currently, advisers organized as a group of related advisers that are separate legal entities but effectively operate as a single advisory business could have to file multiple registration forms for effectively the same advisory business. The SEC staff had previously provided guidance setting forth conditions under which, according to the SEC, one filing adviser could file a single Form ADV on behalf of itself and other relying advisers that are either controlled by or under common control with the filing adviser. Under the proposed amendments, the filing adviser would be required to file and update (as required) a single Form ADV that relates to, and includes all information concerning, the filing adviser

and all relying advisers. This same information must be included in any other reports the filing adviser must make under the Advisers Act and the rules thereunder, such as Form PF.

The SEC has proposed a set of conditions to the availability of umbrella registration, including:

- *Qualified clients; eligibility to invest*. The filing adviser and all relying advisers advise only (i) private funds and (ii) clients in separately managed accounts that are "qualified clients" and are otherwise eligible to invest in the private funds that the filing adviser or relying adviser advises. In addition, the filing adviser and all relying advisers' accounts must pursue investment objectives and strategies that are substantially similar or otherwise related to those private funds.
- *Location in the U.S.* The filing adviser has its principal office and place of business in the United States, and all of the substantive provisions of the Advisers Act and the rules thereunder apply to dealings between the filing and all relying advisers and each of their clients, regardless of whether any client or the filing or relying adviser is a U.S. person.
- *Common control*. All relying advisers, their employees and any persons acting on their behalf are under the filing adviser's supervision and control and are therefore "persons associated with" the filing adviser (as defined in Section 202(a)(17) of the Advisers Act).
- *Governance by Advisers Act*. All relying advisers are subject to examination by the SEC, and all advisory activities conducted by all relying advisers are subject to the Advisers Act and the rules thereunder.
- *Single code of ethics*. The filing adviser and all relying advisers operate under a single code of ethics and a single set of written policies and procedures adopted, implemented and administered in accordance with the Advisers Act.

One difference between the proposed amendments and previous staff guidance on umbrella registration is that the proposed amendments would include a new Schedule R, which would require certain information on each relying adviser such as its address, unique identifier numbers, basis for registration and form of organization. Advisers that previously registered in reliance on the staff guidance did not provide such information.

Amendments to Rule 204-2 under the Advisers Act

The SEC is proposing two amendments to Rule 204-2 under the Advisers Act—the "books and records" rule—that would require investment advisers to maintain additional materials related to the calculation and distribution of performance information.

Rule 204-2 currently generally requires registered investment advisers to maintain records supporting performance claims in communications that are distributed to 10 or more persons. The proposed rules would require advisers to maintain this information if ithe performance claim is distributed to any person.

Rule 204-2 also currently requires advisers to maintain certain written communications received and copies of communications sent by advisers regarding recommendations made to clients, disbursements of funds, and execution of any order to purchase or sell securities. The proposed rules would require advisers to also maintain originals of all written communications received and sent by an investment adviser relating to the performance or rate of return of any or all managed accounts or securities recommendations.

- **See a copy of the release relating to Amendments to Form ADV and Investment Advisers Act Rules**

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.

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