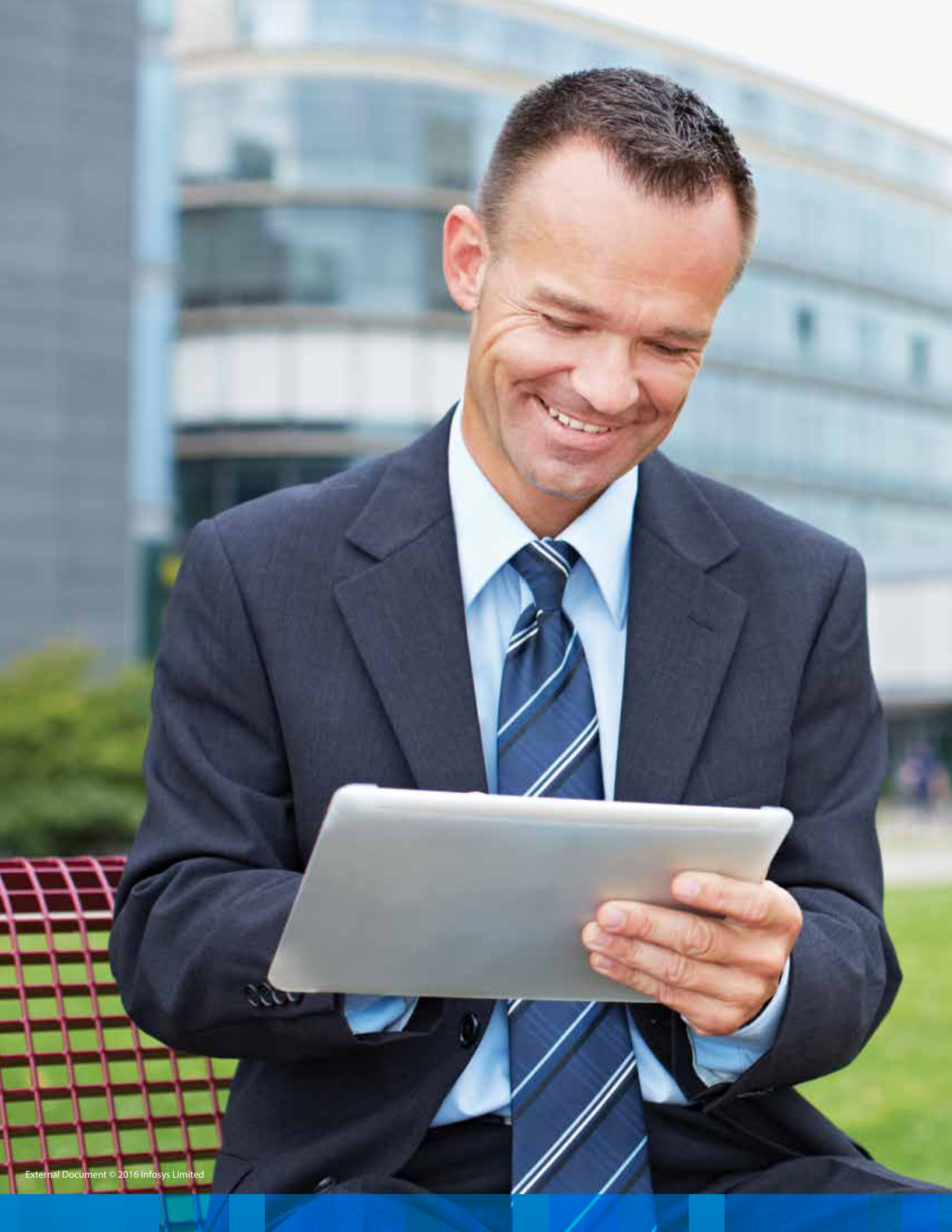


WHITE PAPER

Regulatory Reporting Reforms for Investment Management:
'A Case for a Strategic Regulatory Reporting Platform'





Background and call for action

The investment management industry has seen several key changes in the past few years characterized by an ever-increasing and rapid asset-base growth, new structures, and increasing complexity of the underlying portfolio. Some of the most notable trends are:

- The amount of assets held by US mutual funds, excluding money market mutual funds and exchange traded funds, is increasing rapidly. Assets grew from US\$4.4 trillion in 2000 to US\$15.8 trillion in 2015
- Potentially less liquid mutual fund categories have grown substantially over the same period. For example, foreign bond and foreign equity funds have grown from around 11% of the total industry assets in 2000 to 19% in 2015

There are several other industry drivers for upcoming regulator driven changes in mutual funds industry:

- The long overdue modernization of the reporting requirements amidst

great advances in the technological landscape for aggregation, analysis and reporting information

- Rapid adoption of Internet as a reliable channel for dissemination of information) for Investment Management firms to SEC
- An overarching debate on potential systemic risk posed by Investment Managers and need for greater transparency by Industry participants

These factors have culminated into two recent landmark reforms proposals from SEC:

- Liquidity Risk Management Programs for Open Ended Funds
- Investment Company Reporting Modernization

This paper examines the impact of the modernization of investment company reporting on the industry participants, and our recommended approach to address the same. As part

of this proposal, SEC requires firms to significantly strengthen and update reporting and disclosure of their portfolio holdings. The highlights of this proposed rule are as follows:

- 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
- Enhanced and standardized disclosures in the financial statements
- File a new annual reporting form, Form N-CEN, that would provide certain census-type information to the SEC
- Satisfy transmission requirements by making reports accessible to shareholders on their website

Infosys believes that these changes have a major impact on buy-side firms' reporting processes, data, and infrastructure, and the time to act on these proposals is now.

What are the changes?

Concurrent with the trends in industry, the investment management firms will have to contend with increasing the frequency, enhancing the usability, and improving the quality of the detailed disclosures of the holdings.

The summary of changes to the forms and rules for registered investment companies is as follows:

- A new form, **N-PORT**, has been introduced that would mandate certain registered investment companies to report information about their portfolio holdings in a structured data format (XML) on a monthly basis
- A new form, **N-CEN**, has been introduced requiring registered investment companies to report certain census-type information to the SEC annually. The proposals would rescind

current Form N-Q and Form N-SAR, respectively

- Changes to Regulation S-X, would require a registered investment company to include standardized, enhanced disclosure about its investments in derivatives in its financial statements as well as other disclosures related to liquidity and pricing of investments
- A new rule, 30e-3, allows registered investment companies to transmit periodic reports to shareholders on a website

Form N-PORT

In addition to providing holdings information, firms will have to disclose the following as part of the new Form N-PORT:

- Firms' use of derivatives

- Risk metrics that measure an exposure to changes in interest rates, credit spreads, and asset prices
- Information about securities lending and repurchase agreements including the counterparties that the fund is exposed to
- Information about counterparties in over-the-counter (OTC) derivatives transactions
- Information on the liquidity risk profile of the holding – market liquidity, pricing of portfolio investments, and fund flows

Apart from some general information about the fund that includes name of the registrant, name of the series, Legal Entity Identifier (LEI) number of the registrant, and series, etc., the following table captures the key schedules that are part of Form N-PORT and the corresponding information that needs to be captured:

Schedule	Key information ask
Assets and liabilities	Total assets, liabilities, net assets, miscellaneous securities, assets invested in controlled foreign corporation (CFC) including underlying investments in a CFC
Portfolio-level risk metrics	Interest rate duration, spread duration, liquidity profile of the funds at a portfolio level (funds with >20% threshold for debt and/or derivatives exposure)
Securities lending	Counterparty information (LEI and aggregate value of all securities on loan) and position-level information, fees and revenues associated, and impact on investment performance
Return information	Monthly returns attributable to derivatives and other investments for each of the preceding three months
Flow information	Shares sold, repurchased, reinvested, and redeemed
Schedule of portfolio investments	Investment-wise details – issuer data, amount, payoff profile, fair-value level, whether restricted security or illiquid asset, and counterparty details (in case of derivatives)

Table 1: Overview of schedules

This information needs to be provided monthly in standard XML format within 30 days after close of each month to the Commission, and quarterly to the public (monthly of each fund's fiscal quarter) within 60 days of the end of the fiscal quarter.

Form N-CEN

The information and form attachments for N-CEN would be similar to those currently required on Form N-SAR, including background information about the firm

and its classification, as well as the identity of its principal underwriters and its officers and directors.

The following are salient characteristics of the new form:

- Proposed Form N-CEN would include a new item requiring reporting as to whether the firm relied on exemptions granted by the SEC during the reporting period
- Among other additional items required, the proposed Form N-CEN would include an item relating to whether an open-ended fund made any payments to shareholders or reprocessed shareholder accounts as a result of an NAV error

Other information on Form N-CEN relates to:

- Information on classes of shares
- Information concerning investments in CFCs
- Additional information regarding their securities-lending activities, including whether the firm is authorized to engage in securities-lending transactions and whether

it loaned securities during the reporting period

- Reporting on whether the firm relied on certain rules under the Investment Company Act
- Information regarding expense limitations
- Information on the RIC's service providers



Implications and benefits to market participants

Investors / Shareholders	Market regulator (SEC)	Investment companies / service providers / administrators (custodians)	Intermediaries (broker dealers / investment advisers)
<ul style="list-style-type: none"> Greater transparency through disclosures into fund's exposures, particularly derivatives, miscellaneous securities, counterparties, and overall liquidity profile Flexibility and improved information accessibility via electronic / web delivery 	<ul style="list-style-type: none"> Enable improved analysis and monitoring of systemic risk and counterparty risk Establish further standardization and consistency of reporting information across fund industry, and enable peer analysis Promote industry standards like LEI, XML / XBRL reporting in the fund industry 	<ul style="list-style-type: none"> Increased regulatory burden, operational and technology change impact - manage a much larger data set and report more frequently Increased risk reporting Reduced burden of printing and mailing costs 	<ul style="list-style-type: none"> Additional information and analysis to aid fund investors' decision-making Greater transparency of information regarding loan or borrowing of securities

Table 2: Implications for market participants

Expected challenges

The proposed mandates include substantial changes in reporting for investment companies to the SEC. Some of the key execution challenges are:

<p>1 Lack of data standards</p> <ul style="list-style-type: none"> Availability of Legal Entity Identification (LEI) associated with each fund LEIs for the counterparties 	<p>2 Unavailability of risk metrics</p> <ul style="list-style-type: none"> Fund and portfolio-level calculation of duration and spread associated with debt instruments Liquidity classification of the portfolio holdings 	<p>3 Lack of data granularity of the information</p> <ul style="list-style-type: none"> Investment details of securities classified as miscellaneous Realized appreciation / depreciation associated with derivatives and other instruments on a monthly basis
<p>4 Increased frequency of reporting and reduced reporting window</p> <ul style="list-style-type: none"> The firms will likely struggle with requirement to file the monthly Form N-Port within 30 days of month close and the yearly Form N-CEN within 45 days of year close 	<p>5 Tight implementation timelines</p> <ul style="list-style-type: none"> SEC expects firms to comply within 18 months (likely in early- to mid-2017) 	<p>6 Limitations of the existing technology landscape</p> <ul style="list-style-type: none"> Multiple data sources and limited data reconciliation and aggregation capabilities Absence of a standard reporting solution compatible with regulatory reporting Manual processes for 'record to report' life cycle

Table 3: Challenges



Recommended approach

Infosys recommends utilizing its proprietary services suite – AiKiDo – anchored on industry-leading solutions to meet these regulatory reporting reforms. However, investment management firms will have to adhere to the following tenets before embarking on the road to implement changes proposed by SEC:

- Identify the impact on the business
- Adopt an agile methodology for business and technology implementation
- Choose a strategic solution for regulatory reporting
- Adopt data standards across the enterprise
- Enhance business case of the implementation by including other areas of regulatory reporting under scope
- Enable curation of rules and business logic with minimal burden on business users
- Utilize the opportunity to rationalize the regulatory reporting operating model

Automation and intelligence (Ai)	Knowledge-based management (Ki)	Design for experience (Dō)
Harness capabilities of an industry-leading product in meeting enhanced disclosure requirements out-of-the-box and at an accelerated rate in order to beat the anticipated deadlines by SEC.	Leverage Infosys industry knowledge and non-invasive methods for accelerated definition of data flow, business rules, and reporting processes.	Adopt a design-thinking-led approach and persona analysis for process harmonization and future-state operating model for regulatory reporting.

References

- <https://www.sec.gov/rules/proposed/2015/33-9776.pdf>
- <https://www.sec.gov/rules/proposed/2015/33-9922.pdf>

About the author



Amit Kumar

Senior Principal, Infosys Consulting

Amit has more than 14 years of business and IT consulting experience working with banking and asset management clients in the US, Japan, UK, and India. His expertise lies in IT strategy, business transformation, and program management, especially in the areas of finance transformation, regulatory reporting, and compliance.

For more information, contact askus@infosys.com



© 2016 Infosys Limited, Bengaluru, India. All Rights Reserved. Infosys believes the information in this document is accurate as of its publication date; such information is subject to change without notice. Infosys acknowledges the proprietary rights of other companies to the trademarks, product names, and such other intellectual property rights mentioned in this document. Except as expressly permitted, neither this documentation nor any part of it may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, electronic, mechanical, printing, photocopying, recording, or otherwise, without the prior permission of Infosys Limited and/or any named intellectual property rights holders under this document.

Stay Connected    