SEC Approves New Modernization Rules to Enhance Reporting by Registered Investment Companies

This publication provides more detailed information about the new SEC rules we first described in our publication issued on October 14, 2016 right after they were approved.

By The Investment Management Practice

Overview

On October 13, 2016, the Securities and Exchange Commission ("SEC") voted to approve rules to modernize and enhance reporting of information provided by registered investment companies ("Reporting Modernization Rules"). In a 2-1 vote, with Commissioner Piwowar voting against the new rules, the Commission approved a set of new rules, forms, and amendments that expand and update certain reporting and disclosure obligations of most registered investment companies.

In adopting the Reporting Modernization Rules, SEC Chair Mary Jo White noted that the SEC seeks to improve the quality and type of data that all registered investment companies provide to the SEC and investors. She commented that the current reporting requirements have not substantially changed in decades. Therefore, the current requirements do not fully capture the volume and complexity of information relevant to the SEC, investors, and the markets in general. Chair White further noted that the Reporting Modernization Rules "will give the [SEC] and investors powerful new tools to understand the investment activities of funds."¹

The Reporting Modernization Rules will require certain registered investment companies to report among other things, their portfolio holdings on a monthly basis through the new Form N-PORT (only quarterly N-PORT filings will be made publicly available). In addition, the new Form N-CEN will replace the current Form N-SAR, and will require affected registered investment companies to annually report certain census-type information. New Form N-LIQUID will require a fund to confidentially notify the SEC when the level of illiquid assets exceeds 15 percent of its net assets or when its highly liquid investments fall below its preset minimum, for more than a brief period of time. The new rules also make certain amendments to Regulation S-X² to require standardized, more detailed disclosure in registered investment company financial statements, including specific information relating to derivatives and securities lending. The SEC, however, did not adopt proposed Rule 30e-3 which would have permitted, but not required, registered investment companies to deliver periodic reports to their shareholders by making the reports accessible on a website and satisfying certain other conditions. With respect to Rule 30e-3, SEC Chair Mary Jo White noted that she has directed the SEC staff to
continue to evaluate the validity of the proposed Rule 30e-3, and prepare a recommendation for SEC’s consideration by year-end.³

The SEC will require funds to begin filing reports on new Forms N-PORT after June 1, 2018; however fund complexes with less than $1 billion in net assets will be required to begin filing reports on Form N-PORT after June 1, 2019. This means that larger funds will file reports on Form N-PORT, reflecting data as of June 30, no later than July 30.⁴ With respect to form N-CEN, the SEC set June 1, 2018 as the compliance date for all funds, regardless of size.⁵

I. Form N-PORT

The new form N-PORT will replace the current Form N-Q and will require all registered management investment companies and unit investment trusts ("UITs") operating as exchange-traded funds, other than money market funds and small business investment companies ("SBICs"), to report, in a structured data format, among other things, portfolio holdings on a monthly basis. To facilitate the aggregation and analysis of the reported fund data, the new rule requires Form N-PORT to be filed electronically in the standardized Extensible Markup Language ("XML") format, as has become required with certain other SEC form filings.⁶ According to the SEC, structured XML format will allow for easier processing of data reported and according to the SEC, will allow the SEC to better analyze data collected. Although Form N-PORT will be filed monthly, only a fund’s quarter-end filings will be made publicly available, on a 60-day lag period. Below is a summary of items that funds will be required to report under Form N-PORT:

- **Part A**—General Info
  - Certain information about the registrant, including name, CIK, and LEI number.

- **Part B**—Information about the Fund
  - Information about a fund, including total assets and liabilities and information regarding the fund’s liquidity classifications.
  - If a fund’s debt securities positions for the previous three months, in the aggregate, exceed 25% or more of the fund’s net asset value ("NAV"), the fund will be required to provide information about its portfolio level risk metrics:
    - **Interest Rate Risk**—for each currency for which a fund has a value of 1% or more of the fund’s net asset value, the fund will be required to provide the change in value of the portfolio resulting from a one and a 100 basis point change in interest rates, for each of the following maturities: three month, one year, five years, ten years, and thirty years.
    - **Credit Spread Risk**—a fund will be required to provide the change in value of the portfolio resulting from a one basis point change in credit spreads where the shift is applied to the option adjusted spread, aggregated by investment grade and non-investment grade exposures, for each of the following maturities: three month, one year, five years, ten years, and thirty years.
• Return Information—a fund will be required to provide monthly total returns for each of the preceding three months, including data with respect to net realized gain/loss and net change in unrealized appreciation/depreciation attributable to enumerated categories of derivatives and investments other than derivatives.7 The Adopting Release8 notes that in the past, the SEC’s Division of Enforcement Aberrational Performance Inquiry used similar risk analytics to identify certain private funds with suspicious returns.

• Flow Information—a fund will be required to provide data on aggregate dollar amounts for sales and redemptions/repurchases of fund shares during each of the preceding three months. This information is similar to the information currently provided on Form N-SAR. The SEC noted in the Adopting Release that having this information provided on a monthly basis will allow the SEC to, among other things, examine investor behavior in response to specific market events.

• Highly Liquid Investment Minimum—a fund will be required to provide information regarding its highly liquid investment minimum. This information will be reported to the SEC.

• Part C—Schedule of Portfolio Investments
  • In Part C of Form N-PORT, funds will be required to provide certain information regarding the amount of each investment, asset, and issuer type (e.g., corporate, U.S. Treasury or other). In addition, funds will be required to provide information regarding country of investment issuer and liquidity classifications for portfolio investments,9 certain information with respect to debt securities, derivatives, repurchase and reverse repurchase agreements, and securities lending.

• Part D—Miscellaneous Securities
  • A fund will be permitted to report an aggregate amount not exceeding five percent of the total value of its portfolio investments in one amount as miscellaneous securities, so long as the securities listed are not restricted, have been held for not more than one year prior to the date of the related balance sheet, and have not previously been reported by name to the shareholders, or set forth in any registration statement, application, or report to shareholders or otherwise made publicly available. This information will not be publicly disclosed.

• Part E—Explanatory Notes
  • Funds will be permitted but not required to provide additional information which they believe would be helpful in understanding the information provided in other parts of the Form.

• Part F—Exhibits
  • A fund will need to submit complete portfolio holdings, no later than 60 days after the end of the reporting period, for the first and third quarters of the fund’s fiscal year.
In the Adopting Release, the SEC noted that when compiling the information required by Form N-PORT, a fund may generally use internal methodologies and the conventions of its service providers and may explain such methodologies in Part E of the Form.\textsuperscript{10}

The SEC has clarified that funds will be permitted to report information on Form N-PORT on the same basis as they use in NAV calculations under Rule 2a-4 (generally T+1 basis). In addition, the SEC noted in the Adopting Release that registrants offering multiple series will be required to file a report for each series separately, even if some information is the same for two or more series.\textsuperscript{11}

Finally, the SEC noted in the Adopting Release, that information to be provided on Form N-PORT will enable the SEC to further its mission and regulatory responsibilities, including examination, enforcement, and monitoring of funds. In fact, the SEC specifically noted that information gathered on Form N-PORT may be used in regulatory programs, including examinations, investigations, and enforcement actions.

\section*{II. Form N-CEN}

Form N-CEN will replace current Form N-SAR, and will require all registered investment companies,\textsuperscript{12} including UITs, to report detailed census-type information on an annual basis. This new form will streamline and update information currently reported to the SEC under Form N-SAR. Form N-CEN will be filed within 60 days of the end of a fund’s fiscal year, rather than semi-annually as is currently required.

While many of the items on Form N-SAR carry forward to the amended Form N-CEN, the new Form will also include a host of new information items. Below is a summary of items that funds will be required to provide under Form N-CEN:

\begin{itemize}
  \item **Part A**—Reporting Period Covered
    \begin{itemize}
      \item Funds will be required to indicate if the report covers a period of fewer than 12 months.
    \end{itemize}
  \item **Part B**—Information about the Registrant
    \begin{itemize}
      \item A Fund’s CIK and LEI number, and address and location of books and records.
      \item Information on whether an affiliate or principal underwriter provided financial support during the reporting period. Provision of financial support includes, among others, any:
        \begin{itemize}
          \item Capital contribution;
          \item Purchase of any defaulted or devalued security at fair value reasonably intended to increase or stabilize the value or liquidity of a registrant’s portfolio;
          \item Performance guarantee; or
          \item Other similar action reasonably intended to increase or stabilize the value or liquidity of a registrant’s portfolio.
          \item Information regarding any exemptive orders that a registrant relied on during the reporting period.
        \end{itemize}
    \end{itemize}
\end{itemize}
• Information with respect to any NAV corrections that resulted in payments to shareholders or shareholder accounts reprocessed as a result of an error in calculating a registrant’s NAV.

- **Part C**—Additional Questions for Management Investment Companies

  - Part C will require funds to report, among other things, certain information regarding classes of shares, the type of fund (e.g., ETF, ETMF, Index fund), securities lending activities, whether a fund intends to operate as a non-diversified fund, whether a fund relied on particular rules under the Investment Company Act of 1940, and any principal transactions.

- **Part D**—Additional Information regarding Closed-End Funds and Small Business Investment Companies

  - Items reported under Part D will include, among other things, information with respect to any secondary offerings during the reporting period, share repurchases, net annual operating expenses, and information with respect to certain service providers.

- **Part E**—Additional Questions for ETFs and ETMFs

  - Items reported under Part E will include, among other things, information with respect to the exchange where the ETF or ETMF is listed on, authorized participant information, and information on creation units offered by the ETF or ETMF.

- **Part F**—Additional Questions for UITs

  - Items reported under Part F will include, among other things, information with respect to the depositor, administrators, insurance company separate accounts, trustees, and sponsor.

- **Part G**—Attachments

  - Items reported under Part G will include attachments relating to any legal proceedings, provisions of financial support, change in accounting principles, and practices and information required to be filed pursuant to exemptive orders.

As with Form N-PORT, the new rules require that Form N-CEN be filed electronically in the standardized XML format.

### III. Form N-LIQUID

New Form N-LIQUID generally requires an open-ended fund, including In-Kind ETFs but not including money market funds, to confidentially notify the SEC when (i) the level of illiquid assets exceeds 15 percent of its net assets, (ii) the funds illiquid investments that are assets previously exceeded 15 percent of net assets and the fund determines that its illiquid investments that are assets have changed to be less than or equal to 15 percent of net assets, or (iii) when its highly liquid investments fall below its preset minimum for more than seven consecutive calendar days. Similar to Form 8-K under the Securities and Exchange Act of 1934, or Form N-CR under the Investment Company Act of 1940 for money market funds, Form N-LIQUID requires disclosure, by means of a current report
filed with the SEC, of certain specific reportable events. The information filed on Form N-LIQUID will be kept confidential, however the SEC noted that it may use information collected on the Form in its regulatory, disclosure review, inspection, and policy making rules. A report on Form N-LIQUID is required to be filed within one business day of the occurrence of one or more of these events.

IV. Form N-1A

Amendments to Form N-1A would require a fund to describe its procedures for redeeming fund shares, the number of days in which the fund typically expects to pay redemption proceeds, and the methods for meeting redemption requests, (e.g., selling portfolio assets, holding cash, providing in-kind redemptions, or utilizing a line of credit).

One change of note from the Proposing Release, the SEC did not adopt the requirement that a fund file a credit agreement that it has entered into as an exhibit to the fund’s registration statement.

V. Amendments to Regulation S-X

The amendments to Regulation S-X require registered investment companies, as well as business development companies (“BDCs”), to include in their financial statements a standardized schedule containing detailed information about derivatives investments. In particular, the adopted rules require the presentation of standardized disclosures regarding fund holdings in various open futures, forward and swap contracts, and any written and purchased option contracts.

The new rules also require this disclosure to be placed prominently in a fund’s financial statements, rather than allowing such schedules to be placed in the notes to the financial statements. The changes also require new disclosures in the notes to the financial statements relating to a fund’s securities lending activities, including related amounts paid or received by the fund, the compensation terms of any lending agent, and the monthly average value of portfolio securities on loan. The Reporting Modernization Rules emphasize that the derivatives disclosures required by amended Regulation S-X mirror the corresponding derivatives disclosure requirements in connection with Form N-PORT.

A copy of the SEC’s final rules may be found here.
If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

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2. See rule 1-01, et seq. of Regulation S-X [17 CFR 210.1-01, et seq.]. Regulation S-X prescribes the form and content of financial statements required in registration statements and shareholder reports.
4. The SEC noted that it will maintain as nonpublic all reports filed on Form N-PORT for the first six months following June 1, 2008.
5. The SEC noted that unlike Form N-PORT, the information filed on Form N-PORT during the phase in period will not be kept confidential.
6. For example, Form N-MFP, PF, and 13F will all use XML format.
7. In the Adopting Release the SEC noted that it believes that having this information in a structured format will enable comparison across funds and will allow the SEC to analyze performance data that appears to be “inconsistent with a fund’s investment strategy.”
10. While this information will be reported to the SEC, the information regarding country of investment or issuer based on the concentrations of the risk and economic exposure of the investments, and information regarding liquidity classifications will not be made publicly available. However, the SEC did note that it may use such information in its regulatory programs, including examinations, investigations, and enforcement actions.
11. In the Adopting Release, the SEC removed the definition of “investment grade” and instead noted that a fund will be able to utilize its own methodologies when determining whether an investment constitutes investment grade.

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