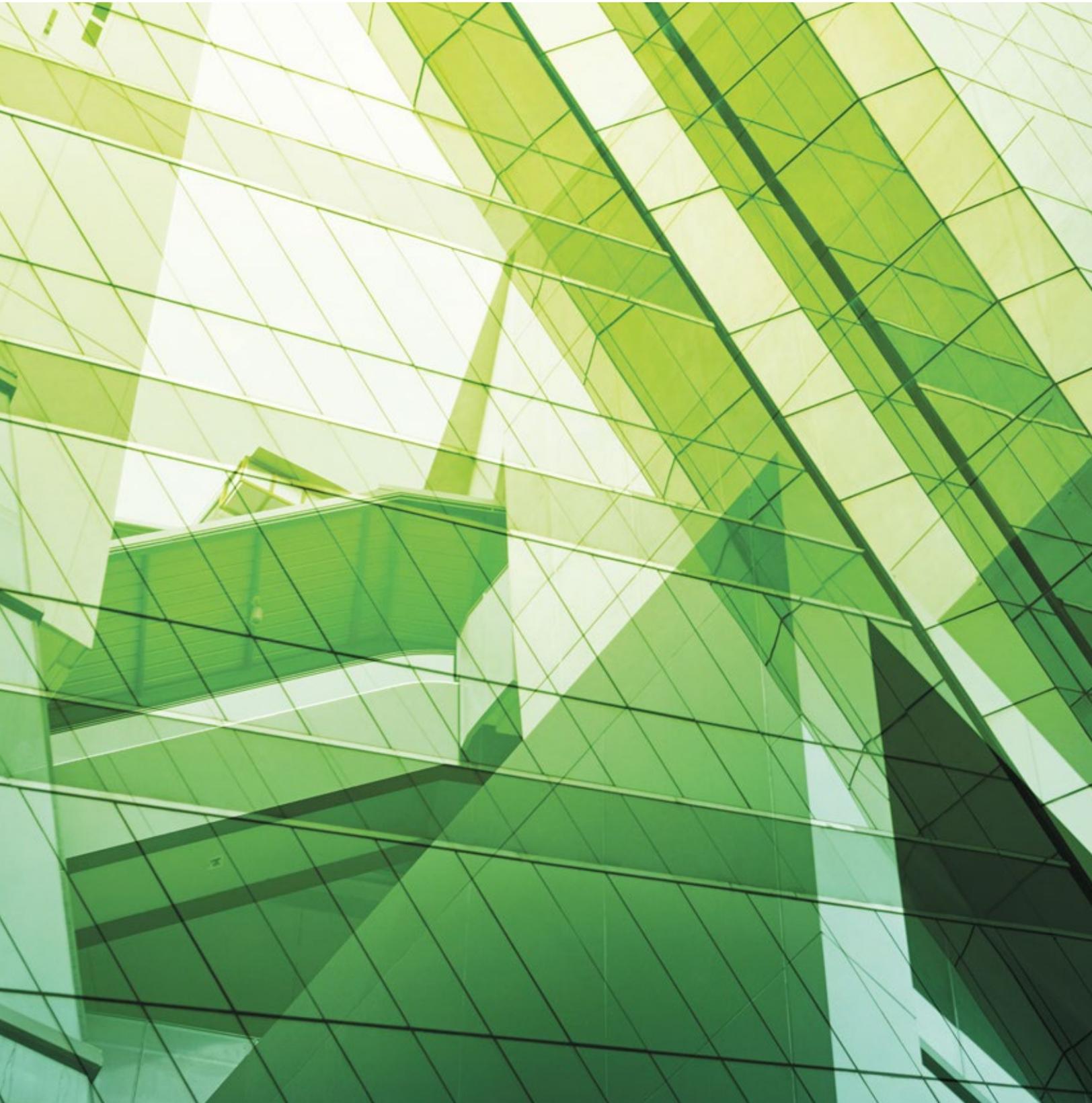




# SEC Modernization Readiness Guide

October 2016





# Contents

---

- 1 SEC Modernization Overview
    - New Form N-PORT
    - New Form N-CEN
    - Amendment to Regulation S-X
  - 2 The Key Driver of SEC Modernization
  - 3 Understanding the Challenges
  - 4 Preparing to Comply
  - 5 Readiness Checklist
  - 6 Confluence Solutions
  - 7 Confluence: Experience You Can Rely On
- 



# 1 SEC Modernization Overview

The Securities and Exchange Commission (SEC) released three major proposals in 2015 impacting mutual funds: Investment Company Reporting Modernization, Liquidity Risk Management, and Use of Derivatives. The first two were finalized on October 13, 2016 while the third is still pending.

As a technology leader committed to solving the fund industry’s growing global regulatory challenges, Confluence has developed this readiness guide to help the industry grasp the magnitude of the SEC Modernization challenge. This readiness guide provides an overview of the new requirements and their challenges. It also provides practical guidance on how to prepare for compliance with the requirements of Form N-PORT, Form N-CEN and the amendments to Regulation S-X.

## What is a Rule?

The SEC’s Investment Company Reporting Modernization covers a lot of regulatory ground – 2 new forms, 8 amended forms, 2 form rescissions, 2 new rules, 4 rule rescissions, 20 amended rules, 3 amended sections of a regulation, 1 rescinded section of a regulation and 2 amended articles of a regulation – all promulgated pursuant to the power granted to the SEC under three different laws.

For simplicity of explanation, in this document we will at times refer to the entirety as a ‘rule’ in the singular.

## SEC Investment Company Reporting Modernization Timeline



Fund families with less than \$1 billion in net assets will have extended compliance periods for Form N-PORT and related changes.

Compliance date refers to **reporting dates** on or after, rather than **filings** required to be made on or after, that date. For example, the Regulation S-X amendments are required for reports dated on or after August 1, 2017 rather than reports filed on or after August 1, 2017.

The SEC Modernization Proposal, Release 33-10231, has three components: New Form N-PORT, new Form N-CEN and amended Regulation S-X.

| Component   | Overview  | Compliance Dates  |
|---|---|---|
| <p>New Form N-PORT and related changes</p> <p>Impacts '40 Act management companies and UITs that operate as ETFs, other than SBICs and money market funds</p> | <p>Form N-PORT collects monthly portfolio information from '40 Act registered, non-money market funds. It is roughly the equivalent of Form N-MFP and Form PF. All three forms gather roughly the same information (portfolio holdings) for the same purpose (to analyze systemic risk and to inform examinations), but for different types of pooled investment products.</p> <p>Form N-Q is rescinded, though operationally it will not go away, it just no longer needs to be certified. In the first and third quarter, funds must include a Regulation S-X compliant set of Article 12 schedules – essentially Form N-Q – as Part F of Form N-PORT. With the rescission of Form N-Q, the Form N-CSR certification will cover six months.</p> <p>For Form N-PORT, the SEC estimates an effort of 168 hours per year per fund with automation.</p> <p>Form N-PORT will be filed monthly within 30 days, except for Part F, which will be filed within 60 days.</p> | <p>Fund families in excess of \$1 billion in net assets: June 1, 2018 for Form N-PORT and certification amendments to Form N-CSR, August 1, 2018 for the rescission of Form N-Q</p> <p>Fund families with less than \$1 billion in net assets: June 1, 2019 for Form N-PORT and certification amendments to Form N-CSR, August 1, 2019 for the rescission of Form N-Q</p> |
| <p>New Form N-CEN and related changes</p> <p>Impacts all registered investment companies, except face-amount certificate companies</p>                        | <p>Form N-CEN reports what the SEC refers to as "census information", which is mostly static information on the fund such as the fund's auditor and how the fund is registered.</p> <p>Form N-SAR is rescinded.</p> <p>The Form N-SAR exhibit reporting a change in independent registered public accountants moves to Form N-CSR.</p> <p>We estimate that Form N-CEN will take slightly less than half the preparation time of Form N-SAR.</p> <p>Form N-CEN will be filed annually within 75 days of the fund's fiscal year end or calendar year end for UIT's.</p>   | <p>June 1, 2018</p>   |
| <p>Amended Regulation S-X and related changes</p> <p>Impacts '40 Act registered investment companies except face amount certificate companies</p>             | <p>New Article 12 disclosures consistent with the information reported on Form N-PORT were added to Regulation S-X, along with the corresponding balance sheet changes, as well as a change in tax disclosures. Additional securities lending disclosures in the Statement of Additional Information, or in Form N-CSR for closed-end funds.</p>  | <p>August 1, 2017</p>   |

**The Politics of Rule 30e-3**

The SEC Modernization proposal included the new Rule 30e-3, which would allow funds to default to electronic delivery for their financial statements.

That part of the proposal met strong opposition from some influential special interest groups, including the paper and envelope industry, which led to a separation from the remainder of the proposal that was adopted on October 13. It is likely that the SEC will revisit electronic delivery by the end of 2016.

## 2 The Key Driver of SEC Modernization

---

Why has the SEC put forth the modernization initiative? The short answer: to collect more data and to collect it in a format that is machine readable, allowing them to enhance their analysis. The collection of this data will provide a means of monitoring and mitigating systemic risk. Secondly, it will inform examinations and inform new rulemaking.

The SEC already receives systemic risk information from private funds on Form PF and from '40 Act money market funds on Form N-MFP. In the asset management space, that left two gaps in the SEC's collection of systemic risk information, separately managed accounts and '40 Act funds that are not money market funds. SEC Modernization fills one of those gaps through Form N-PORT. At the same meeting in which the SEC finalized the SEC Modernization rules, they also finalized changes to Form ADV to fill the second gap, changes that were finalized on August 25, 2016, IA-4509.



### What is XML?

XML is data that has been assigned standardized tags that denote the meaning of each data item. XML enables computer systems to read and understand the values that appear in a report and allows for the automation of data analysis, especially comparisons between funds and time periods.

The sample XML below from Form N-MFP provides the information on the balance sheet of the fund as of the reporting date.

```
<cash>0.00</cash>
<totalValuePortfolioSecurities>130469529106.81</totalValuePortfolioSecurities>
<amortizedCostPortfolioSecurities>130453711697.97</amortizedCostPortfolioSecurities>
<totalValueOtherAssets>151420524.11</totalValueOtherAssets>
<totalValueLiabilities>108817292.88</totalValueLiabilities>
<netAssetOfSeries>130512132338.03</netAssetOfSeries>
```

# 3 Understanding the Challenges

---

## Form N-PORT

Form N-PORT will be the most onerous of the proposed rules and will be the most time consuming. The SEC estimates an effort of 168 hours per year per fund with automation. Form N-PORT will need to be filed monthly within 30 days of month end.

A major challenge lies in figuring out how to source the data, especially data not held by accounting, and figuring out what to do with it to determine the answers on the form.

- The number of data sources increases substantially
- Multiple sources for the same data
  - Especially when dealing with multiple accountants and administrators
  - The same data may take different forms that require different transformations
  - The same data may be sourced directly in some cases and in other cases the components are sourced and the data is calculated
- Some raw-source data will be T+1 and some raw-source data will be T+0
- The need to purchase a large amount of unused market data

A second challenge is the need to reuse and reconcile data that is used for other purposes. Roughly 77% of Form N-PORT questions overlap with data required for financial reporting. Form N-PORT will report on T+1 information while financial statements will use trade date information, creating multiple versions of the truth and making reconciliation more difficult. Roughly 67% of Form N-PORT questions overlap with Form CPO-PQR questions, and there is no indication that the SEC will incorporate a substituted compliance regime to eliminate the redundant reporting.

In addition to the data challenges, Form N-PORT compliance will also require building intuitive subject matter expertise in new areas such as risk analytics and liquidity risk management. XML filings will require an automated solution. Lastly, hiring the staff needed to complete the additional work will be a major challenge.



## Form N-CEN

Form N-CEN will present the challenge of redundant review and approval of static information. Like Form N-PORT, the required XML filings will require automation.

## Regulation S-X

As it requires the same new data sources, the Regulation S-X changes have the same data management challenges as Form N-PORT. Avoiding redundant work by utilizing a single initiative to solve a single data management challenge will be key.

# SEC Modernization Challenges At A Glance

## Form N-PORT

- Substantial data needs – relating and using a multitude of current and new data sources and reusing and reconciling data that is used for multiple purposes
- Building subject matter expertise in new areas such as risk analytics and liquidity risk management
- XML filing
- Hiring the staff necessary to meet the additional workload

## Form N-CEN

- Redundant review and approval of static information
- XML filing

## Regulation S-X

- Redundant work required to reuse and reconcile data that is used for multiple purposes

## 4 Preparing to Comply

---

While the final SEC Modernization rule is still pending and compliance periods are many months away, with the substantial challenges Form N-PORT, Form N-CEN and Regulation S-X entail, now is the time to begin to prepare.

### EDGAR Filings

Like Form N-MFP, Form N-PORT and Form N-CEN will be filed via the SEC's Electronic Data Gathering and Retrieval (EDGAR) system. EDGAR is the SEC's mechanism for collecting company filings as well as providing public access to public company filings.

### What do you need to do to be ready for Form N-PORT?

First and foremost, you need to source new data, especially data not used for financial reporting today. Financial reporting requires sourcing, relating and scrubbing six to eight data files. Form N-PORT will expand that effort to 20 to 30 data files. Create a grid of each question and the source of that data (starter grid available to Confluence customers via our support site).

There is certain information that may not be prepared today, or may not be prepared using the methodology required by the SEC, such as:

- Duration (B3.a-b)
- Liquidity risk management calculations (B7 and C7)
- Options Delta (C11.c.vii)
- Options Gamma (C11.c.viii.1)
- Options Vega (C11.c.viii.2)

As well, Form N-PORT requires new market data, such as LEIs throughout and derivatives reference information (C11).

In order to accurately report on these new calculations, back-office teams will need to build intuitive subject matter expertise in new areas like risk analytics (what is the acceptable range of values for Options Delta?) and liquidity risk management (what is a less liquid asset?).

While the vote occurred at the same meeting, the SEC failed to synchronize the first Form N-PORT filing with the Liquidity Risk Management Rules, meaning that you will need to be prepared to make a quick change in your filing setup and XML schema once the liquidity risk management information is required in the December 2018 filing.

Finding the incremental personnel required to prepare Form N-PORT, adding them to your team and training them in advance of the first filing will be a major challenge.

Finally, you will need to determine a method for filing in XML, which cannot be done manually.

### What do you need to do to be ready for Form N-CEN?

First, you will need to determine a method for filing in XML, which cannot be done manually. On an ongoing basis, since the filing is almost entirely static information, the challenge will be setting up exception- and delta-based reviews to prevent reinventing the wheel each time Form N-CEN is filed.

### What do you need to do to be ready for the Regulation S-X changes?

The most challenging part of Regulation S-X readiness will be sourcing the data and storing it in a way that it can be used to make the new disclosures. Fortunately, you will need to go through this exact same exercise as a part of your Form N-PORT preparations, so if you have an integrated financial reporting and regulatory reporting system, your Form N-PORT preparations can be reused for Regulation S-X, and vice versa. Other than data management, you will also need to be sure you have resources set aside to update your holdings disclosure templates.



# 5 Readiness Checklist

---

Now that the SEC Modernization rule has been adopted, the graphic below illustrates the key considerations necessary for ensuring readiness. As referenced in Section 6 of this paper, Confluence has the expertise and solutions to help you every step of the way.



## Create a data mapping of each Form N-PORT and Form N-CEN item

- Where does it overlap with your current processes?
- Where does it overlap with the S-X changes?
- How will you source the risk and liquidity management calculations?
- How will you fill your market data gaps?
- Data source starter guide available to Confluence customers on our support site.



## Prepare your SEC Modernization budget

- What will the new incremental market data cost?
- What will the new or incremental risk and liquidity management cost?
- What will the outsourcing cost?
- What will the software and incremental FTEs cost?
- Be ready to factor in the impact of Rule 30e-3.



## Resource the work, initially and ongoing

- How many FTEs will you need to request?
- When will you need the FTEs requested?
- When will you need the FTEs approved?
- When will you need the FTEs hired?



## Don't forget the miscellaneous changes

- What do you need to do to include the new securities lending disclosures in your SAI process?
- What do you need to do to extend your Form N-CSR certification to cover 6 month and include the change in independent registered public accountings exhibit?

## 6 Confluence Solutions

---

Confluence estimates that our solutions will reduce both the time spent preparing for and the ongoing resources expended on Form N-PORT and Form N-CEN by up to 80 percent. As well, Confluence solutions will reduce risk by making it feasible to complete an accurate Form N-PORT filing in 30 days, providing a controlled system to facilitate collaboration, review, standardization, and providing an audit trail for external regulatory examinations and inquiries.



## 7 Confluence: Experience You Can Rely On

---

Confluence has been the asset management industry's leader in data management for 25 years and has a depth of experience in data management for systemic risk reporting through six years of experience with Form N-MFP, Form PF, Form CPO-PQR, Form NFA-PQR and AIFMD Annex IV. Based on that experience, we have dedicated a significant portion of our research and development budget to improving the sophistication of our data management, form building and filing capabilities. The result of these efforts is Unity NXT™ Regulatory Reporting, our consolidated regulatory reporting platform.

In addition to our depth of expertise with systemic risk data management and reporting, we also have a depth of expertise specific to SEC Modernization. At Confluence, we have been developing our strategy and providing information to the market on SEC Modernization since early 2014 when we participated in the ICI's working group that met with the SEC during the proposal's planning phase. Since the proposal was released, we have held a series of webinars, interviews and requirements deep dives with a cross section of the market.

Finally, Confluence has a wide breadth of solutions that share the same data set. Both our financial reporting and regulatory reporting solutions utilize a common system to load, define and relate raw data. This makes Confluence the only provider that offers solutions for financial reporting, Form N-PORT (77% data overlap) and Form CPO-PQR (66% overlap). As regulators continue to blur the lines between human-viewable and machine-readable output, as with the Form N-PORT and Regulation S-X components of SEC Modernization, partnering with Confluence to leverage our ability to accommodate all forms of output from a single set of shared data is the best strategic move.

For more information, call us at 412-802-8632, email [info@confluence.com](mailto:info@confluence.com) or visit the Confluence SEC Modernization Resource Center at <https://www.confluence.com/en-us/resources/?SEC-Modernization-7>.



## About Confluence

As a global leader in data-driven solutions for efficiency and control, Confluence solves tough data management and automation challenges for the asset management industry, including performance reporting, regulatory reporting, investor communications and fund expense management. Confluence solutions enable asset managers and third-party administrators to consolidate and leverage data across business operations which results in lower costs, reduced risk, decreased reporting turnaround times and the scalability to automate more processes without additional resources. The platform features solutions to support a wide array of fund types – including mutual funds, ETFs, alternative investments, institutional portfolios and UCITS funds. Seven of the top 10 global service providers license Confluence products and eight of the top 10 global asset managers have business processes automated through Confluence.

Headquartered in Pittsburgh, PA, Confluence serves the international fund industry with locations in Brussels, Dublin, Ho Chi Minh City, London, Luxembourg and San Francisco.

For more information, visit [www.confluence.com](http://www.confluence.com).