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Understanding the requirements, impacts, challenges, and opportunities

On October 13, 2016, the Securities and Exchange Commission (SEC) adopted new forms, rules, and amendments to modernize the current reporting and disclosure requirements of certain Registered Investment Companies (RICs).

The table below provides a summary of the new and additional requirements of the final SEC Modernization Rule.

<table>
<thead>
<tr>
<th>Form, rule, or amendment</th>
<th>Requirements of form, rule, or amendment</th>
<th>Compliance dates</th>
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<tbody>
<tr>
<td>New form</td>
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<tr>
<td>N-PORT (replaces Form N-Q, which will be rescinded as of August 1, 2019)</td>
<td>• Impacts RICs and Exchange Traded Funds (ETFs) organized as Unit Investment Trusts (UITs), except money market funds and Small Business Investment Companies (SBICs).&lt;br&gt;• Requires information on derivatives including type of derivative instrument within each asset category; repurchase agreements; controlled foreign corporations; legal entity identifier; securities lending activities; qualitative analysis, including strategy/risk; portfolio and position-level risk analytics; flow information; total returns for each of the preceding three months; and liquidity levels.&lt;br&gt;• Monthly filings no later than 30 days after each month-end, with every third month made publicly available 60 days after quarter end.&lt;br&gt;• Filed in Extensible Markup Language (XML).&lt;br&gt;• Portfolio information must be reported on the same basis used to calculate a fund's net asset value, which is generally T+1.</td>
<td>• June 1, 2018 compliance date; first file date is July 30, 2018, based on data as of June 30, 2018 (for RICs greater than or equal to $1B in AUM)&lt;br&gt;• June 1, 2019 compliance date; first file date is July 30, 2019, based on data as of June 30, 2019 (for RICs less than $1B in AUM)</td>
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<td>New form</td>
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<td>N-CEN (replaces Form N-SAR, which will be rescinded as of June 1, 2018. Last filing on Form N-SAR will be for funds with semi-annual periods ending March 31, 2018.</td>
<td>• Impacts RICs, including money market funds.&lt;br&gt;• Expanded to reflect new market developments, products, investment practices, and risks.&lt;br&gt;• Information about a fund's directors and chief compliance officer.&lt;br&gt;• Requires census-type information, including background and classification of funds; investments in controlled foreign corporations; securities lending—collateral manager, lending agent, reporting period, and fund expenses waived, reduced, or recouped.&lt;br&gt;• Disclose reliance upon certain rules under the Act during the reporting period.&lt;br&gt;• Filed 75 days after fiscal year-end for RICs and 75 days after calendar year-end for UITs in XML format.&lt;br&gt;• Information on exemptive orders being relied upon.</td>
<td>• June 1, 2018 compliance date; first file date is 75 days after fiscal year-end for RICs and 75 days after calendar year-end for UITs</td>
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| **Amendment to Regulation S-X** | • New and standardized disclosures in fund financial statements and changes to disclosures of open futures, forward Foreign Exchange (FX), swap, and option contracts.  
• Disclosures related to referenced rates and spreads, realized gains or losses, and total net increase or decrease in unrealized appreciation or depreciation for affiliated investments.  
• Requires funds to indicate the interest or dividend rate and maturity date for certain debt instruments; identify securities held in connection with open put or call option contracts and loans for short sales; identify whether a derivative cannot be sold because of restrictions applicable to the investment. | • August 1, 2017 |

New Rule 30e-3 was not adopted in the final rule. The SEC may consider adoption in a future regulatory setting.
As the primary regulator of the investment management industry, the SEC continually identifies opportunities to address growth and complexity in the industry. In addition, as RICs grow they will continue to innovate through the introduction of new products, fund types, and strategies. While the industry has experienced unprecedented growth, the environment in which investment managers operate has also evolved. Specifically, the introduction of secure, easily accessible data sources such as the cloud, firm web portals, and other automated web-based solutions have emerged as primary tools for sharing and analyzing information. Harnessing this available technology can help the SEC consume data from RICs in a more streamlined fashion, leading to enhanced aggregation and dissemination capabilities. The combination of a growing and complex industry and the cutting-edge technology designed to support it has led the SEC to adopt a rule which modernizes the current reporting regime by improving the quality of data provided to investors and helping regulators collect and analyze fund data more efficiently.

The below graphic illustrates the specific drivers behind the SEC’s rule to increase reporting regulations.

<table>
<thead>
<tr>
<th>New product structures</th>
<th>Technology advances</th>
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<tbody>
<tr>
<td>• New fund types and increased use of derivatives have added complexity and risks to the fund strategies.</td>
<td>• New data formats allow the SEC to improve their collection and analytics of reported information.</td>
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</table>

<table>
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<tr>
<th>Data aggregation and analysis</th>
<th>Reporting utility</th>
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<tr>
<td>• New reporting requirements enable investors and other market participants to simplify aggregation and analysis efforts.</td>
<td>• Existing reporting requirements have become outdated or of limited usefulness to the SEC, market participants, and investors.</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Compliance examinations and inspections</th>
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</thead>
<tbody>
<tr>
<td>• New reporting requirements enable the SEC to compare/analyze information across the industry to identify trends, outliers, and data inconsistencies.</td>
</tr>
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</table>
Key challenges

In order to satisfy the requirements of the Modernization Rule, fund sponsors and service providers will be encouraged to invest in people, process, and technology to address challenges.

The graphic below depicts the potential industry and infrastructure challenges with corresponding opportunities.

### Industry challenges

| Data sourcing and aggregation | • Information required by form N-PORT and N-CEN is unlikely to be captured from a single-source system.  
| • Liquidity risk levels may not be currently readily available. (See new Rule 22e-4, the newly adopted rule requiring investment companies to implement liquidity risk management programs.)  
| • Flow information will be sourced from financial intermediaries.  
| • Third-party service providers and RICs will need to reevaluate data collection and processing requirements. |

| Implementation timeline | • Large fund complexes will need to do the following by June 1, 2018:  
| – Obtain project funding  
| – Implement a new target operating model  
| – Hire and train resources  
| – Perform functional testing as well as finalize procedures and controls |

| Compressed filing timeline | • N-PORT is required to be filed monthly within 30 days of month end instead of 60 days after first and third quarter end for Form N-Q. The following may pose submission error risk in a compressed timeline:  
| – Manual hours of data collection and report creation  
| – Intermediaries and service providers involved in compiling the data  
| – Increased frequency of filings to the SEC |

| Complex calculations | • Form N-PORT will require complex calculations at a high frequency for portfolio risk metrics information and monthly returns attributable to derivatives. |

### Infrastructure challenges

| Strategic challenges | • Additional departments will need to provide input to complete form N-PORT and N-CEN.  
| • Involve the appropriate resources required to interpret rule requirements.  
| • Develop testing strategy along with business requirements early in the process.  
| • Increased oversight of service provider(s) that support data collection, processing, and form filing. |

| Operational challenges | • Enhance procedures for ongoing data collection, validation, and filing with the SEC.  
| • Increase resources to accommodate compressed and increased filing timelines. |

| Technology challenges | • Developing appropriate data sourcing and aggregation processes, including solutions to:  
| – Perform calculations  
| – Derivatives disclosures  
| – Validate data and store data elements |
Opportunities

Similar to other modernization initiatives driven by the SEC, opportunities will be available for firms that move efficiently to invest in people, process, and technology initiatives. The demands placed on RICs to comply with the Modernization Rule will create opportunities to enhance existing reporting infrastructure.

**Centralized database**
- The Modernization Rule will present an opportunity for fund sponsors to utilize a centralized database pulling from various source systems to generate reports for shareholder and regulatory needs.
- Previously inaccessible data, such as counterparty information, may now be accessible from a central database.

**Automated reporting**
- The Modernization Rule will prompt third-party service providers to automate their reporting processes, thereby expanding automation capabilities across the reporting ecosystem.
- The new XML format will allow RICs to aggregate and analyze data more quickly and reduce the need for manual processing or data entry.

**Enhanced oversight**
- RICs may use the new information to identify enhancement opportunities within internal compliance and audit programs and proactively address compliance issues.
- Compliance can leverage additional information to provide observations and recommendations that can improve regulatory reporting as well as operational and technological infrastructure.
Based on our considerable time spent in discussions with fund sponsors and service providers, many organizations are in varying stages of response to the Modernization Rule.

**What should you do now?**

1. **Initiate planning**
   - Outline roadmap to guide implementation of systems and processes to support compliance with the Modernization Rule.
   - Assemble a dedicated team of business, operational, compliance, technology, and legal representatives.
   - Develop an understanding of the final Modernization Rule.
   - Identify the strategic impact of the Modernization Rule on current organizational initiatives.
   - Build a business case and seek funding to implement and operate target operating model.

2. **Assess capabilities**
   - Analyze the impact of changes to technology, such as regulatory reporting system upgrades, to meet the requirements of rule and amendments.
   - Identify whether current data architecture can satisfy rule requirements.
   - Consider organizational ownership and human capital requirements.
   - Determine the impact of the final requirements on existing regulatory reporting processes.

3. **Engage externally**
   - Consult with existing custodian(s), fund administrator(s), intermediaries, and other external parties to identify operational and technology gaps, especially for RICs that rely on external service providers to support regulatory reporting activities.
   - Assess intermediary and service provider capabilities to absorb reporting requirements.
   - Evaluate transformative opportunities to reduce duplicative reporting functions and enhance the current operating model.
Approach to readiness for new mutual fund regulation

Preparation for a new regulation typically requires a phased and disciplined approach. To address the challenges presented by the Modernization Rule, fund sponsors and service providers should develop a detailed understanding of the impact of the requirements and then develop and implement a strategic solution.

**Deloitte Advisory’s readiness approach**

| Requirements analysis | • Interpret applicable form requirements and determine necessary disclosure requirements, including disclosures related to portfolio risk metrics and securities lending activities.  
|                       | • Document scope of data and business requirements. |
| Gap assessment        | • Assess rule requirements against current-state operating model, including data aggregation and reporting capabilities.  
|                       | • Review relevant policies and procedures, as well as service provider contracts/agreements and identify gaps in current state model. |
| Solution design       | • Design future-state model based on identified requirements and review internal systems and processes, as well as vendor and service provider solutions.  
|                       | • Select external solution or develop solution architecture for new forms’ requirements. |
| Implementation        | • Develop implementation plan and implement selected processes and solutions, including enhanced procedures.  
|                       | • Test proposed solutions and train resources. |
Requirements analysis and gap assessment

 Fund sponsors and service providers should evaluate current-state infrastructure against the final Modernization Rule requirements. The resulting gap analysis outlines possible enhancements to people, process, and technology and can provide a road map to implement the new regulation as described below.

**Define and analyze requirements**
- Analyze and interpret disclosure requirements on forms N-PORT and N-CEN and identify data, process, and technology requirements, including applicable system upgrades/configurations.
- Determine requirements for calculation methodologies for portfolio/position risk metrics.
- Determine requirements to comply with Regulation S-X, including new derivative data requirements for disclosure in shareholder statements.
- Identify intermediary and service provider requirements within external data feeds (e.g., flow and counterparty information).
- Develop traceability matrix based on the requirements.

**Perform gap analysis**
- Review internal systems and capabilities and determine ability to generate and validate data for forms N-PORT and N-CEN.
- Close the gap for current capabilities to comply with new requirements of Regulation S-X.
- Review current policies and procedures in contrast to new requirements of forms N-PORT, N-CEN, and Regulation S-X.
- Contrast regulatory requirements to capabilities of current operating model.

**Develop gap assessment**
- Document anticipated impact of forms N-PORT, N-CEN, and Regulation S-X on operating model.
- Identify areas in the current state that may enable enhancements.
- Outline road map to design future-state operating model.
Solution design and implementation

The Modernization Rule requirements challenge fund sponsors and service providers to develop a solution to capture and aggregate a wide spectrum of data in a short timeframe. An implementation plan can provide a controlled and cost-effective schedule of activities for executing the solution design, with limited interruption to existing operations.
What can Deloitte Advisory offer?

For each step of the process, Deloitte Advisory has developed clear standards and methodologies to assist with a controlled and effective implementation of new regulations. Below are select value-added tools, accelerators, and methodologies that Deloitte Advisory can offer.

**Scoping/Mobilization**

Fund sponsors and service providers need to establish project standards, capabilities, and consistencies to develop program governance and drive decision making.

**Key objectives**
- Mobilize resources and develop integrated project plans to provide a controlled and cost-effective schedule of activities for executing the model design with limited interruption to existing operations.
- Agree on the scope for the overall effort which will be used to refine the overall project plan as well as identify where and how the organization and Deloitte can jointly work together.

**Key activities**
- Identify stakeholders and align to project workstreams.
- Establish workstreams, as well as scope and objective for all workstreams.
- Initiate communication with potential stakeholders.
- Define project scope encompassing required data elements on Form N-PORT and Form N-CEN.

**Key deliverables/outputs**
- Business case and roadmap.
- Identified workstreams and staffing models.
- Established program governance.
- Responsibility assignment matrix.
- Project plan and risk register.
Impact maps and inventory

Through our work with industry participants, Deloitte Advisory has developed process maps and inventories that identify and describe the various ways existing compliance, operational, and technical processes are impacted across an organization. Additionally, the maps and inventories identify where changes will likely be needed to people, process, and technology.

Solution implementation

Deloitte Advisory can assist with solution implementation that may involve systems upgrades/configurations, acquisition and integration of data sources, data validation and approval processes, interface development, creation of user guides/playbooks, and end-user training and external website updates to comply with modernization requirements.
The Deloitte Advisory difference: Compliance Suite™

Deloitte Advisory’s proprietary technology, Compliance Suite™, helps fund sponsors and service providers prepare and respond to the Modernization Rule requirements. This platform is a powerful and dynamic technology solution that assists in the preparation of Form N-PORT, N-CEN, Form PF, AIFMD, and other regulatory filing requirements.

The benefits of working with Deloitte Advisory

- Deep technical knowledge and experience in understanding new regulations, identifying key impacts and considerations, and implementation planning and execution.
- Leading provider of professional services to the investment management industry sustained by relevant engagement qualifications and thought leadership.
- Provider of offerings and services that address market issues, regulatory requirements, and transformation opportunities.
- Compliance Suite™ offers a single data repository that automates the collection, storage, calculation, and management of data required for preparing regulatory filings.
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