31 October 2013

IMA SORP – 2013 Exposure Draft

Fair value disclosures

Q1. How many funds do you expect to have significant numbers of instruments that are valued using unobservable inputs?

We envisage having many funds with these instruments, with a small number of these instruments actually held by those funds.

Q2. Do you have systems or processes in place to support the IFRS reporting levels?

Yes, and understand our TPA also does.

Q3. Do you agree that the SORP's emphasis justifies the additional disclosure category for unobservable inputs? If not, please explain.

Yes

Fair value disclosures: additional points

In relation to the fair value disclosures we have discussed that bank holidays / timing differences between when markets are open may cause investments to move category year on year. We think the SORP should provide guidance on this and clarify that these conditions should **not** result in a change in category. FRS 102 states that "A financial institution shall disclose information that enables users of its financial statements to evaluate the significance of financial instruments for its financial position and performance." Therefore to change the category due to timing difference would go against the objective of the disclosure required by FRS 102.

Risk disclosures

Q4. Do you agree with the generic approach for all authorised funds or should it be more focussed on UCITS with non-UCITS funds being dealt with by exception in appendix III?

To the extent that the information provided for a UCITs fund can be disclosed in such a way to comply with the information required for a non-UCITS fund the approach should be generic so the disclosure is consistent across funds. Where extra disclosure is required for a non-UCITS this should be contained within the appendix.

Q5. Do you agree with the integrated approach of using a single set of disclosures to satisfy the regulatory and accounting requirements?

Agree. However, it should explain what information needs to be disclosed within the financial statements (for example where comparatives are required to meet the requirements of FRS102) and that which can be included alongside the portfolio because comparatives are not required. For example we have included the details of counterparties underneath the portfolio statement.

As another example, it is suggested that the portfolio be used to comply with certain requirements of FRS102, such as for the currency disclosure however comparative information by value is not included in the portfolio statement.

It would be particularly useful to provide an example of a structured approach that would satisfy the requirements (both UCITS and non-UCITS).

AIFMD

Q6. Do you think the SORP should define realised and unrealised gains / losses for non-UCITS funds?

Yes, so that there is consistency across the industry.

Q7. If so, should it use definition A, B or something else?

Something else. For open ended funds the split between realised and unrealised is not a useful number, and to comply with AIFMD it makes sense to make this disclosure in the notes to the financial statements. Fund's falling under AIFMD should apply a consistent calculation and therefore as it is our understanding that the calculation used in Europe is generally disposal proceeds less cost this is the method that should be used in the UK.

Performance and charges

Q8. Do you think the proposals will help investors better understand the performance and costs? If not, please suggest how it might be improved.

Change in net asset value per share table

To the extent that some performance data in relation to the financial year should be disclosed, a reconciliation of the opening and closing NAV per share does give the shareholder an understanding of the returns to their share class.

We agree that it is more useful for an investor to see all returns applicable to the class they hold in one table rather than separating out the various returns into separate tables. It is also a positive change to link the performance numbers to the financial year of the fund.

"**Total return before charges**" includes a number of different costs of investing:

- Transfer taxes;
- Commissions;
- Portfolio dealing spread; and
- Dilution adjustment (which reduces these costs for existing shareholders).

Therefore, to just disclose the pence per share value of the transfer taxes and commissions only tells the investor part of the story. Whilst it would be preferable to be able to disclose details of all costs associated with investing we understand this is not practical.

Therefore, to enhance the disclosures as they stand the pence per share number disclosed should be "transaction costs less amounts recovered on shares issued and cancelled". For a bond fund this number will still be zero therefore narrative disclosure to this affect would be more appropriate.

Distributions are only shown for income shareholders. While we understand that distributions are less relevant to accumulation shareholders as they are reinvested, is the FCA happy that accumulation distributions will only be shown in the distribution tables in the annual report especially as there is currently a requirement for short reports to include this information?

Should interest distributions be shown net or gross? Gross would make a better comparison and be consistent with the treatment of the income tax.

Operating charges

We understand the requirement to breakdown the operating charges further, however should shareholders want to understand what is in their operating charges a split between those paid to the manager and those paid to other parties (broken down if material) doesn't tell the whole story. It may be the case that there are very little fees paid to other parties because the manager pays those out of their fee. The guidance says if material? Please can some guidance be given on materiality – for example should it be based on fund value or percentage of total expenses?

Some guidance is needed to explain what costs should be brought into the operating charges line. For example it could be read that only the costs included in the expense note should be included.

For comparability to the ongoing charges number the methodology should be the same, therefore the custodian transaction charges which are included in the capital gains/ losses note should be included.

Additionally guidance should be provided for the calculation of “charges made in underlying schemes” and if it is the charges after this number that feeds into the change in net asset values table. The following items should be included in this calculation:

- OCF of underlying funds
- Rebates of management fees from underlying funds reflected in the capital gains and revenue notes

Short reports require ongoing charges number to be quoted and also require the short report to be consistent with the comparative table. We would suggest that the operating charges & ongoing charges % both be shown if there is a difference, if there is no difference then the narrative below the table should sate that operating charges % is also the ongoing charges %.

<u>Transaction charges disclosure</u>

The annual report isn’t the most appropriate place for this disclosure, however we understand that by making it a requirement of the SORP it will be compulsory for all funds to disclose this information – which is a good thing.

As mentioned above, we understand what the IMA is trying to achieve here in terms of transaction costs, but feel that it still doesn’t give shareholders the full story. To do so would require the spread on each purchase / sale to be calculated and disclosed alongside the full extent to which any dilution adjustment reduces these. However, we understand that this disclosure would not be practical.

We welcome the addition of the dilution adjustment to the table to show the extent to which the broker commission and taxes for an equity fund have been limited to transactions from investment decisions.

The table showing transaction charges would show zeros for a bond fund – even though charges are inherent within the spread on investments. There is no benefit of showing a table with zeros. It makes sense to disclose the portfolio dealing spread at the balance sheet date to give shareholders an idea of the other costs associated with dealing.

However, extra narrative disclosure is also required to put this in perspective – especially for a bond fund. The SORP should provide guidance on this narrative disclosure, similar to that required by the enhanced disclosures. This will then put the spread into context in terms of the types of investments held for example the spread will be larger on certain types of investment.

In addition to the narrative disclosure the Portfolio Turnover Rate should be disclosed to put into perspective the extent to which the portfolio spread may limit performance.

Will the IMA be updating its enhanced disclosures guidance to take into account the proposals of the SORP?

Q9. Are there any aspects of the proposals that you think will be particularly troublesome to produce?

We think it will be relatively hard to split broker commission between execution and research based on a fund’s financial year. This split is currently given for a calendar year in the level 2 disclosures.

We understand from our administrator that the breakdown of the dilution levy as it relates to just commissions and taxes may be hard to calculate. It would be useful if the IMA suggested a calculation – for example to split the dilution adjustment by applying average split between the portfolio spread and notional dealing costs.

We also believe that it should not be an optional number.

We believe most numbers are fairly easy to calculate however would appreciate some guidance to be issued so a consistent calculation is applied across the industry. For example:

- Using average shares in issue;
- that total return before charges is the balancing number;
- distributions gross or net

- Total return after charges % = total return after charges / share as a percentage of opening nav per share.

We understand from our administrator that comparatives may be difficult to provide.

Income recognition

Q10. Do you agree with the implication of the principles for recognising revenue from debt securities?

This seems very sensible.

Aggregation

Q11. Do you agree with the removal of the aggregation?

Agree, this makes complete sense especially under the protected cell regime.

Effective date

Q12. What do you think would be the earliest feasible effective date?

The effective date should be as soon as issued, but with later adoption permitted for some areas. If the proposed effective date was January 2015, would the accounts be compliant for the AIFMD requirements – it is not particularly clear exactly when annual reports need to be compliant with the AIFMD requirements – accounting periods starting on/after or ending on/after authorisation?

Q13. Which requirements need an earlier effective date?

Most changes could be adopted immediately, with a number of changes to be delayed.

Q14. Which requirement should be deferred?

It may be challenging for administrators to provide comparatives for certain information – for example in the transaction costs table, therefore could this be adopted for accounting periods ending after the SORP is published, but for comparatives to be provided the following years, so that in the first year there would just be numbers for the current year end and by the 3rd year the table would be complete.

Q15. Do you think the proposed SORP satisfied the requirements of FRS 102?

Presentational Currency

The SORP doesn't provide guidance on the presentation currency of the financial statements for an umbrella where sub-funds may have different functional currencies and choose to present their financial statements in those functional currencies. Reading FRS102, we believe that it is possible to present the sub-funds in their functional currency, and that there is no further need to translate this into the base currency of the umbrella.

Portfolio

It is implied that the portfolio could be used to satisfy the required disclosures however this is outside of the audited financial statements and would not have comparatives and would therefore not be compliant with FRS102.

Q16. Do you have any other comments on the proposed SORP?

Short reports

Has the FCA indicated if COLL will be amended to include any of the comparative table's requirements into the Short Reports?

Portfolio transaction costs – note to the financial statements (paragraph 3.35)

The SORP notes that certain transactions should be excluded from the table, which we agree with. However, the SORP is silent on how derivative transactions feed into this table. For example, where a fund has significant investment in derivatives there will be associated transaction charges – which would be included in this table. It would be useful for the SORP to provide guidance on what should be included as purchases and sales, for example should futures be included at the value of their exposure?

Risk disclosures

Please can the SORP provide guidance to explain if the only ‘leverage’ undertaken is short term borrowing for settlement purposes, are the leverage disclosure requirements triggered?

Fiscally transparent holdings

To account for all fiscally transparent holdings in accordance with the SORP will be very difficult. It would be sensible if the SORP could provide guidance that this should only be followed if the holding is significant.

Accounting for CIS holdings

We understand that the intention is that income will generally be accounted for on XD date however this is not how the SORP is drafted. "…recognised as revenue when the units are priced ex-distribution **unless sufficient relevant and reliable information** about that income is available to enable recognition before that date." Where we have funds holding fund's within our range the administrator must have **sufficient relevant and reliable information** to price the underlying funds. Therefore, in accordance with the SORP they would have to recognise the income from these funds before the XD date. The sentence needs redrafting so that it permits either treatment.

The ability to recognise income before XD date is important for a master feeder structure. Please can the SORP provide further guidance on how this should be applied in practice – for example a cancellation of shares in the feeder will result in both an equalisation adjustment on the cancellation and following the cancellation of shares in the master (where an equalisation adjustment will also be processed) a further reduction in the amount of income accrued in the feeder where the number of shares held in the master reduces. This can result in doubling up the reduction of income in the feeder fund. We are currently processing an adjustment to reverse out the equalisation adjustment made in the feeder.

Dilution adjustment (paragraph 3.48A)

This is made clear for single priced funds, what about dual priced funds – should the adjustment from mid to bid or offer be separated out?

Related Party Disclosures

Whilst it is clear from the SORP that the ACD is no longer a related party it is not clear if the Trustee is a related party or not.

PDF Format

It would be much more user friendly if the SORP could be saved in a PDF that would permit text to be copied from it. UK FRS do not restrict copying from the PDFs of the standards.

Paragraph 3.4 still refers to the Financial Services Authority – this needs amending to FCA.