IMA SORP Financial Statements of Authorized Funds 2013 – Exposure Draft

Invitation to comment – BNY Mellon Fund Accounting Response

31 October 2013

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

We do not expect there to be a large volume of instruments valued based on unobservable instruments. Correspondingly numbers of funds impacted are also likely to be low but there may still be a reasonable volume where there are odd holdings with unobservable input techniques being used for valuation purposes.

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

Yes the systems have been developed to provide Topic 820 (FAS157) and IFRS 13 compliant reporting.

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

Yes. We believe that the category for unobservable inputs is a good compromise to the problem of the difference between IFRS and FRS 102 fair value hierarchies. Equally it should ensure that authorised funds are not misrepresented in terms of the valuation technique 'quality' when compared to entities applying full IFRS.

This disclosure reflects the fact that prices based on unobservable inputs are the least reliable evidence of fair value and this is in line with both IFRS and FAS 157 fair value hierarchies. In practice, for the funds which we administer, this additional sub category within FRS 102 level 3 is unlikely to include a large number of instruments.

We would also encourage the IMA to continue dialogue with the FRC re potential convergence of the FRS102 fair value valuation disclosure requirements with IFRS as we deem the differences to be unhelpful and unnecessary.

(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?

We administer both UCITS and non-UCITS funds and as such a generic approach would make our process easier and would be more most appropriate for NURS and UCITS funds which logically should not have different reporting & disclosure requirements.

However we also note that trying to provide the generic commonality could lead to inadvertent application of unwanted requirements or may pose difficulty in terms of SORP wording and therefore the IMA should carefully judge the appropriateness of the approach in this light.

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

Yes. This avoids overlap and provides the opportunity to give more meaningful overall disclosure in tune with the actual risks and operational risk management processes employed by the entity.

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

Yes, for the purpose of consistency. Equally without a viewpoint taken the 'discussion' will likely be passed to a technical one with individual auditors and one that is unlikely to have a consistent outcome.

(Q7) If so, should it use option A, B or something else?

We are of the opinion that the AIFMD requirements do not add any beneficial reporting for authorised funds and there does not appear to be any rationale supporting the importance of the disclosure.

As such we believe that it is important to review whether the SORP should provide simple AIFMD compliant disclosure (which would minimise UK operational impacts) versus trying to further enhance the requirement e.g. by technical interpretation of 'what is realised'.

In this light we equally feel that (given AIFMD is a European applicable regulation) the IMA should consider carefully corresponding approaches for equivalent investment entities governed by other SORPS (e.g. Investment Trusts) and other jurisdictions (e.g. Irish entities applying FRS102 and AIFMD) and ensure that there is both appropriate consistency where possible and that UK entities are not put at an unnecessary disadvantage re reporting requirements that may be deemed to be 'low value'.

With regard to the specific options there is an obvious third option re the use of historic cost which would be the basis of our core system gain loss calculations (and likely also for other fund accounting providers).

This option and those of A and B have advantages and disadvantages with the trade-off of operational processes for the reporting and the quality of disclosure delivered with the balance again influenced by the discussion referred above.

In terms of the simple A and B choice whilst option B has technical merit and might in practice limit changes to current reporting it is difficult to gauge impact and in this light the certainty and consistency of A (whilst an unhelpful regression to the pre 2005 SORP) may be preferable.

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

Yes. The current comparative table disclosure is of limited use. The proposed disclosure is much more meaningful in that it shows an investor how the value of his units have moved during the period showing clearly how much of the movement related to investment performance and also how much to manager's charges, transaction and other costs.

The above notwithstanding though we would note that the annual accounts is probably not the best place for this disclosure given the aspiration to get this information in a clear domain for investor consumption. However we equally recognise the compliance rationale that the SORP provides.

Whilst the SORP does not govern the short report we encourage the IMA to consider carefully with the FCA how the short report and other manager disclosures should be adapted in the light of the new performance and cost reporting agreed within the SORP.

Also we note there may need to be additional narrative disclosure or 'tweaks' to basic reporting to ensure the tables do not provide simple but slightly misleading information for investors. Examples might include the performance differences between Income and Accumulation units and the reflection of transaction costs for bond funds.

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

The split of commissions between execution and research would need to be sourced (as this sub-analysis is not held in fund accounting systems) and also the 'amounts recovered on units issued and cancelled' within Transaction costs will require additional fund information and may prove practically difficult.

(Q10) Do you agree with the simplification of the principles for recognising revenue from debt securities?

Yes. We believe that given the often simplified amortization approaches in other jurisdictions then the flexibility around approach is welcome and will allow for more operational competitiveness. Equally, and probably more importantly, the removal of the 'effective yield link' to IFRS driven standards will ensure that the operation of funds is not compromised by further technical accounting standards changes to amortised cost determination (e.g. expected credit loss models).

However we would recognize that UK operations are likely to continue mainstream use of effective yield amortization and in this light the continuation of IMA guidance on this approach, outside of the SORP, is still helpful. In a general context it would seem appropriate for the IMA to reconsider the additional guidance in the light of the finalised new SORP.

(Q11) Do you agree with the removal of the aggregation?

Yes. We believe the aggregation, particularly in the light of the protected cell regime, is now of little value to the reader of the financial statements. Its removal will simplify both preparation of the accounts and the accounts themselves.

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

For mandatory application we believe 1 January 2015, in line with FRS 102, is the appropriate effective date but allowing for early adoption.

Given the SORP changes reflect a mixture of accounting changes, regulatory changes and highlighting or 'what can be done now' it may be appropriate for a short guidance note on the different elements to ensure entities do not fall foul of early SORP adoption where this is not practical or latest SORP adoption where elements needed to be implemented pre this point.

(Q13) Which requirements need an earlier effective date?

As per Q12 consideration of the requirements which are driven by in force or future (e.g. AIFMD) regulatory disclosures which may not be in sync with the FRS102 effective date may warrant guidance.

(Q14) Which requirements should be deferred?

N/A – see Q12 and Q13

(Q15) Do you think the SORP satisfies the requirements of FRS 102?

Yes.

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

(i) Paragraph 3.41a requires dividends on short positions to be included within 'Interest payable and similar charges' in the Statement of Total Return. We believe, that this is inconsistent with paragraph 2.28 and that this would produce inconsistent disclosure for long and short positions.

For example long and short equity swap positions in the same security held for the same period (ignoring bid-offer spread and transaction charges) should show zero capital gain and zero revenue. The proposed disclosure would show revenue to the value of the dividends for the period and interest expense the same.

(ii) ESMA disclosures on derivatives exposure and counterparty risk/Collateral.

We believe that it would be useful for the SORP (or other IMA guidance) to provide more guidance on these disclosures as there is currently confusion within the industry. The funds exposure to use of derivatives to leverage exposure in the underlying and the value of that exposure should be clarified as distinct from counterparty exposure and collateral held to mitigate the risk of that exposure.