October 31, 2013

Via electronic submission: financialreporting@investmentuk.org

Mr Mark Sherwin
Investment Management Association
65 Kingsway
London, WC2B 6TD
United Kingdom

**Exposure Draft: SORP for UK Authorised Funds**

Dear Mr Sherwin

State Street Global Services ("State Street") appreciates the opportunity to comment on the Exposure Draft: SORP for UK Authorised Funds ("ED") issued by the Investment Management Association ("IMA") which outlines the recommended practice for financial reporting of UK Authorised Funds.

The new ED sets out a revised Statement of Recommended Practice (SORP) for the financial statements of UK Authorised Funds with proposed revisions to take into account a number of changes to the regulatory and accounting frameworks within which these funds operate. It is understood that the main changes that have been taken into account include:

- The publication of a new set of UK Financial Reporting Standards ("FRS")
- The transposition into UK law of the Alternative Investment Fund Managers Directive ("AIFMD")
- The amendment of the Financial Services and Markets Act to allow a new type of fund, the authorised contractual scheme

We further understand that at the same time the IMA has taken the opportunity to make other improvements to the SORP and introduce a template for presenting information about performance and charges during the reporting period.

Please find below our responses to the questions in the Invitation to Comment document which are of the greatest relevance to us or have been highlighted during discussions with our clients as of most significance to them.

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

State Street expect that the number of funds holding instruments valued using unobservable inputs would account for only a small proportion of the overall population. However, the main consideration should be how many individual securities derive valuations from unobservable inputs as this is the key driver for the effort. The subsequent accounting disclosures in terms of the tiers would require a process for each of these securities.

Under IFRS requirements there is a necessity to provide a reconciliation of securities moving in and out of level 3 during the period. Under FRS 102 and the new SORP is there a similar requirement for this type of reconciliation?

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

Although a process has been implemented for the IFRS 3 tier reporting level the ED applies a combination of the tiers applicable to IFRS and FRS 102 resulting in 4 levels and as such the impact of this and potential process enhancements must be considered.

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

The SORP places emphasis on disclosures in respect of instruments where significant judgement has been exercised which are presumed to be less liquid or riskier in nature and therefore potentially of more interest to current and future investors.

However, the inclusion of a 4 tier disclosure approach, including those elements relating to unobservable inputs is over and above the requirements of FRS 102 and also further classifies the requirements of IFRS. As such process enhancement requirements and the implications for data sourcing and gathering should be considered prior to the implementation of a full 4 tier system. In addition, although the unobservable inputs classification is potentially key for the recognition of unrealised gains/losses for NURS funds, this should not be considered a driver for this part of the requirements.

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

State Street is in agreement with this generic approach. If authorised funds are to be comparable regardless of whether they are UCITS or non-UCITS then it makes sense that the disclosures set out in the SORP are as consistent as possible for both fund types.

It is debatable whether all the investors in the funds are likely to be fully aware of whether it is a UCITS scheme or a NURS fund and as such consistency between the disclosures is clearly in the best interests of the users of the financial statements.

In addition, a consistent reporting framework has additional benefits such as being able to compare data across funds and the comparison of returns. In addition, it also allows the industry to maintain single underlying processes and therefore systems can be built on similar platforms regardless of the nature of the scheme.

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

State Street is generally in agreement with this approach as this would allow the SORP to be a single port of call for all disclosures, avoiding unnecessary duplication and maintaining a consistent approach to risk management.

However, State Street would question whether a more focused approach to the delivery of information to investors would be more meaningful and provide information targeted to individual investors as opposed to providing a document containing all information for all types of investors within the fund.

Such an approach would allow the investor quick and easy access to information on the returns and risks of their holdings without the need to trawl through what may potentially be a significant amount of data on multi-class funds.

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

State Street believes that the SORP should provide a definition for realised and unrealised gains/losses for non-UCITS funds in order to ensure a consistent approach to the reporting requirements of these funds whilst still maintaining an overall resemblance to the UCITS schemes and thereby ensuring investors can recognise and compare financial statements.

However, State Street would urge consideration to be given as to the application of the AIFMD requiring this information, in particular assessing whether this analysis is indeed required, whether these disclosures will be applied consistently across all jurisdictions and finally whether there is potential for any lobbying to amend the underlying regulations.

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

Of the two options provided, State Street would propose option B. Whilst option A would allow a consistent process to be applied across the security universe it is likely to be offline in nature as systems historically capture gains/losses from purchase cost and so option B, which captures only instruments valued using unobservable inputs, would require this process for a much smaller population.

However, this definition raises a question in relation to the tax impact of crystallising gains and losses. In general tax follows the accounting treatment and if gains/losses are in practice being treated as crystallised then will HMRC look to apply this to non-reporting offshore fund gains, i.e. treat all unrealised offshore gains as realised at the end of the period? The implications for this could be significant as no relief is given for losses arising on offshore holdings.

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

State Street is confident that presenting performance data into individual tables for each share class will give more clarity than previously and therefore allow a more straightforward comparison of performance and a more transparent breakdown of the expenses. The greatest concern is the volume of data required for funds with large numbers of share classes.

State Street believes that the inclusion of a standard accounting return calculation provides investors with a consistent benchmark with which to assess investment performance.

State Street would argue, however, that the high/low price information provides no added value to the investors in relation to the performance of the fund and has no relevance.

In addition, State Street is aware of concerns amongst clients in relation to the new disclosure requirements stipulated in 3.12C, particularly in relation to the breakdown of commissions into respective execution and research elements. This is mainly due to 3 reasons:

- Competitive advantage – a number of clients do not wish to make this information publicly available
- Comparative data not available or data not captured for the fund accounting period ends
- Whether the materiality is significant enough to warrant a further breakdown

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

As outlined above State Street has been made aware of concerns from a number of clients in relation to the transaction cost disclosures required by 3.12C as it could divulge sensitive information, may not be available for the accounting period ends or may not be separately identifiable historically for comparative information.

As such, we would propose a re-visiting of the information to be included within the SORP and removal of the requirement to include this table for accounting periods ending on or after 31 March 2014, instead implementing the finalised version in line with the remainder of the SORP for accounting period commencing on or after 1 January 2015.

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

In principle, State Street agrees that it is beneficial to remove the requirement to amortise using only the EY method, allowing other appropriate methods to be selected and providing the opportunity for UK funds to market themselves on an equal footing with other European funds where applicable.

However, specific guidance for stocks which are difficult to amortise has been removed. State Street would suggest that this was useful direction and would propose that for some areas such as Index-Linked securities this guidance could be reinstated in the SORP.

In addition, there is no guidance in respect of which amortisation methods are acceptable or what transition methods should be applied in the event of a transfer of methodology. Whilst State Street acknowledges the aim of the ED to provide greater flexibility to Investment Managers to structure their products there is a concern as to the impact this flexibility may have in terms of disparate accounting models.

***Q11:*** *Do you agree with the removal of the aggregation?*

State Street agrees with the removal of the aggregation if possible under the COLL as it is of limited use when comparing funds and does not add anything to the accounts as a whole. There is no logical reason to produce aggregated financial statements, as the information contained is not relevant to any individual investor.

***Q12:*** *What would you think would be the earliest feasible effective date?*

State Street believes that an adoption date for periods commencing on or after 1 January 2015 is an appropriate date for full implementation of the new SORP.

Some provisions of the new SORP will be readily available although other aspects will not and as such State Street does not consider it practical or feasible to act on an unpublished version of the SORP in terms of initiating system or process amendments.

Other considerations in respect of the availability of comparative data should be taken into account and whilst early adoption is always encouraged guidance should be provided in respect of transitional arrangements such as partial adoption, inclusion of key provisions and how disclosures should be reflected in the absence of historical data.

***Q13:*** *Which requirements need an earlier adoption?*

State Street do not believe that any elements, out with those required by other regulation such as ESMA, should be adopted earlier than the mandatory effective date.

However, as outlined above, early adoption is encouraged and where possible can be implemented. Again, State Street requests that guidance is provided in respect of transitional arrangements.

***Q14:*** *Which requirements should be deferred?*

It has become clear that the ‘Comparative Table’ has generated strong feelings across a number of our clients and the early implementation date for this section appears unduly aggressive.

State Street would propose deferral of this section until the full implementation date for accounting periods commencing on or after 1 January 2015.

***Q15:*** *Do you think the proposed SORP satisfies the requirements of FRS 102*

State Street believes that the ED covers the requirements of FRS 102

***Q16:*** *Any other comments?*

In the current SORP a provision for a Deferred Tax Assets should be made where Excess Management Expenses ("EMEs") arising within the fund have the potential to be utilised in the future. The proposed SORP aims to define share specific policies. If a Deferred Tax Asset ("DTA") recognition is to be applied to individual share classes, the provisioning may become extremely complex where some share classes within the fund have EMEs and one or more share classes have a tax liability. Where one share class's EMEs is used to cover other classes' liability a DTA recognition may arise within the share class which is not utilising its own EMEs.

Where relief between classes arises and the EMEs reside in capital, should the relief go to capital or income, bearing in mind the principle being applied where this happens within a class?

As a result significant implications of the vastly increased complexity are ranging from the practicality of system developments to the increased risk of material mistake.

The SORP has highlighted the fact that different share classes can have different distribution periods. This could cause issues, especially for an interest fund which makes monthly distributions in income classes (expenses charged to capital) and an annual distribution for accumulation classes (expenses charged to capital). Some investors could manipulate the system and so turn income into capital by converting accumulation shares into income shares just before the end of the annual accounting period so only receiving one months' income, for tax purposes, rather than 12.

If this were to happen the other way then existing investors in the accumulation class would end up paying for the tax on the created income. Bearing in mind HMRC's anti-avoidance campaign and the fact that they are looking to redefine the way in which bond funds and streaming work to reduce tax seepage, this policy could have significant implications for the funds industry

Thank you once again for the opportunity to comment on matters raised within the ED. Please feel free to contact me should you wish to discuss State Street's submission in greater detail.

Sincerely,

David Cochrane

David Cochrane
Vice President, State Street Global Services