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BNP Paribas Securities Services is a wholly-owned subsidiary of the BNP Paribas Group, delivering flexibility and commitment, backed by the strength of a leading universal bank.

Operating across the investment cycle, we provide post-trade administration solutions to buy-side and sell-side financial institutions and issuers. The bank has a local presence across 34 countries and global coverage of 100 markets, offering a one-stop shop for all asset classes, both onshore and offshore, across the globe.

With \$7,679 billion of assets under custody, \$1,381 billion assets under administration and approximately 7,000 funds administered as at 31 June 2013, BNP Paribas Securities Services is a top five provider of securities services\*\*.

*\*Rated A+ by Standard & Poor's*

*\*\*Source: Globalcustody.net competitors' AuC tables*

## **IMA SORP REVISION – COMMENTS ON EXPOSURE DRAFT**

### **UK FINANCIAL REPORTING STANDARDS**

#### **Fair value disclosures**

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

*We would expect very few funds across our entire client universe to have instruments falling into this category.*

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

*Yes, we have existing processes in place based on the IFRS definitions. Until now these have applied mainly to investment trusts, life funds and some other funds.*

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

*Yes, we are comfortable with the SORP's approach. As the definitions per FRS 102 are different from those per IFRS as this will require additional systems development to produce the UK tables. The SORP's attempt to bridge the gap between the two regimes through the additional sub-analysis is welcome, although additional time and cost will still be required. We also agree that the emphasis should be on those instruments where significant judgment has been involved.*

#### **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 being dealt with by exception in Appendix II?*

*In principle yes, but we have found that the disclosures required by the ESMA 2012 Guidelines have not always been easy in practice and so would prefer to avoid these being extended to non-UCITS funds. Please also refer to the additional comments below.*

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

Yes. We particularly note the comment in the Invitation to Comment that the approach taken in the SORP maximises the use of existing systems and processes. The challenge will be to see this happen in practice.

With regards to both of these questions we appreciate that the overall aim is to provide disclosures that are meaningful and relevant, and therefore in principle support what the SORP is trying to achieve. However, we have found the implementation of the disclosures arising from the ESMA 2012 Guidelines has caused many practical difficulties and we would suggest that the SORP could be used to provide further clarity.

Specific points of note which we would make in this regard are:

1. Scope - The ESMA Guidelines state that the disclosures apply to all financial derivative instruments which give exposure to an asset. However we have seen different interpretations as to what this actually means, for example, with interest rate swaps.
2. Presentation - The ESMA Guidelines state that disclosures should be included in the annual report and paragraph 3.67B of the SORP then states that the disclosure should be given in the notes. We ask whether this could be made more flexible to allow the disclosures to be made elsewhere, for example by including additional information within the portfolio statement or within the investment manager's report? This would potentially avoid needless repetition. For example, with regards to forward foreign exchange contracts we have found that the main impact of the additional disclosure requirements has been to require names of counterparties to be given, and a simple way of achieving this has been by noting these in the portfolio statement against the relevant contracts. If disclosure is required to be in the notes then this could essentially lead to similar information being included there too.

## **AIFMD**

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

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

Yes, we believe some guidance in the SORP would be helpful. On balance, we are in favour of definition A as this should be consistent with approaches used for other vehicles such as offshore funds. However, applying definition A would mean in practice that we were returning to the situation of many years ago, leading to time being spent producing a split which adds little value and we would therefore want to see this apply only to Non UCITS funds.

## 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.

No. We do not believe that the extra disclosures are merited.

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

We have a number of concerns:

1. The sheer scale of these disclosures is worrying. Because tables will be required for each share class per sub-fund, this could mean that for an umbrella fund with many sub portfolios, each with a number of share classes, the new disclosures will run to many pages.
2. The proposed earlier effective date for this part of the SORP means that this could apply for accounting periods ending on 31 March of 2014 which gives little time to prepare for implementation.
3. The requirement for these tables to cover the last three years will also add to the time involved in preparation, particularly in the first year when historical information will need to be sourced.
4. The breakdown of the commission figure between execution and research will cause problems. This breakdown is not something that third party administrators will necessarily have, so this would have to be provided by the manager, which at the very least will add another complexity into the preparation process.

Generally we question what is the added value of this degree of extra disclosure, bearing in mind that for most investors it is the short report that is the key communication.

## Income recognition

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

It seems surprising that the IMA should take the decision not to comply with IFRS and UK GAAP on the basis of simplification. Accounting bodies have spent much of the last 30 years trying to converge standards and so a divergence applied on the grounds of expediency seems a step in the wrong direction. Investment trusts and other investment vehicles not complying with the SORP will continue to apply effective yield so major investment houses and administrators will still need systems that can comply with IFRS and GAAP – the only difference will be in trying to compare returns on effective yield compliant funds and non compliant funds.

There are some specific issues with the SORP as drafted:

- Any method for spreading the premium or discount will be permitted as long as it gives a 'reasonable comparable result' to the use of effective yield. What is the percentage movement on the revenue account that is reasonably comparable – 0.1%, 0.5%, 5% etc? How is this going to be proved to auditors without calculating the effective yield on the more

material fixed income securities? This is actually an increase in workload not a decrease. And what if individual positions 'fail' the test – which will happen with any high EIR fixed income security – does that mean we have two streams of securities, those using EIR and those not. What happens when at first purchase a security passes the test and is not using effective yield – it will have to be tested on each subsequent purchase to see if it remains reasonable comparable.

- All guidance on convertible bonds has been removed. Does this mean that the discount or premium on these is taken from the total cost of the security ignoring any element in that cost that might be to reflect the convertible nature of the security? This would mean the yield on a non convertible bond bought at the same cost as a convertible bond would be identical – this does not seem to reflect reality. The current method of using comparable bonds is equally flawed. The only true method is one that values the option and removes it from the original cost but this has many practical issues. One issue that was not discussed in the original SORP was whether different treatments were required for convertible bonds that were materially 'in the money' – at which point does the 'economic substance' argument come into force and the security is treated as equity?
- The guidance for securities denominated in a foreign currency has been removed. No matter what method is being used it should be carried out in the currency of the security and then translated at the exchange rate on the date of recognition to comply with GAAP – even if not using effective yield.

## **Aggregation**

Q11. Do you agree with the removal of aggregation?

Yes. The only reason for aggregation was due to the risk of contagion, and since this is no longer present there is no benefit in producing aggregated statements.

## **Effective date**

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

We believe that the effective date for all items should be for accounting periods beginning on or after 1 January 2015, to be consistent with FRS 102. There should be an option to early adopt which would mean that in the case of a new fund launch for example this could avoid the need to prepare initial financial statements to comply with the current SORP only for the format to change fairly soon afterwards.

Q13. Which requirements need an earlier effective date?

Q14. Which requirements should be deferred?

The earlier implementation date for the performance and charges tables should be deferred (although please also see the response to questions 8 and 9 above).

**Other**

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

Generally we believe that the SORP supplements FRS 102 well. Our major concern with FRS 102 related to the differences in the fair value hierarchy definitions and we believe the approach suggested in the SORP provides a useful attempt to deal with the issues caused by this in a practical way.

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

We are concerned that the addition to paragraph 2.33 could be difficult to implement in practice and also create inconsistencies in treatment between funds and indeed also lead to different CIS holdings within funds being treated differently. For example a fund may have a portfolio which includes a CIS managed by the same Manager and others managed by an external Fund Manager. The new wording seems to open up the possibility that the change in the income element within the value of the in-house holding should be identified separately and reflected as revenue (purely on the basis of having the information readily available). The external holding on the other hand would not be split but just reflected within capital until its XD point. Separating out movement in the NAV between income and capital would be an additional process and so involve extra time and cost.

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