



Keeping up with Regulatory Reform – Derivatives Valuation and Financial Disclosure

By Russell Warren

In this post market crisis era, the financial services industry has been faced with unprecedented focus on regulatory reform including a series of regulations designed to provide improved disclosure and transparency to shareholders, particularly with respect to derivatives. As we navigate the impacts of these reforms for our clients, derivatives valuation standards and financial reporting disclosure are two areas where we expect significant impact for our fund services clients.

Derivatives Valuation Standards

Today, fund sponsors must focus not only on the increasing regulatory requirements for disclosure and transparency, but also on improving the standards for derivatives valuation. Gone are the days when firms could rely on the brokerage community to provide daily pricing of derivatives. Over a short period of time, independent pricing vendors have largely replaced broker or investment manager-supplied valuations for derivatives, setting the standard with the same scrutiny, data scrubbing and second-sourcing previously only typical for equities and bonds.

In keeping with the rapid pace of development and increasing complexity in the derivatives market, J.P. Morgan continues to enhance its centralized pricing unit by supporting multiple external vendors and offering an in-house valuation service to provide derivatives pricing coverage. Many of our clients are now using a combination of vendors for both primary and second-sourced prices, providing independence and robustness to the valuation process, to the benefit of fund boards, management companies and their pricing committees. Clients may also

utilize customized reporting, which provides information such as price movement exceptions, to help them better manage fund risk and support valuation oversight committees.

J.P. Morgan's unique ability to leverage the depth of skills and expertise developed within our investment bank ensures we can keep pace with development of new derivatives and trends in the market. This specialist approach, combined with the global strength and capability in our fund servicing locations provides our clients with comprehensive coverage of the over-the-counter (OTC) derivatives market.

Financial Reporting Disclosures

J.P. Morgan Fund Services teams are engaged globally with the impact of regulatory changes to financial disclosure requirements for our clients. In the U.S., financial disclosure for derivatives will be constantly changing as the SEC continues to review language and focus on improving transparency for shareholders, with the goal of providing a simple, clear understanding of the use of derivatives by portfolio managers. Changes will not only impact financial statements but also changes to the prospectus and SAI—a move away from boiler plate language to specific disclosures on the actual intention of the fund investments. This increased focus on clarity is intended to help the investing public better understand the risks of investing in a particular mutual fund, ETF, or other investment company,



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and result in enhanced information reporting in financial statements, shareholder reports and registration statements.

As clients have come to rely on service providers to administer funds, the role of the provider has taken on a greater degree of importance for enabling compliance in this ever-changing regulatory landscape.

Client Education

Regulatory change is often highly complex. Clients and administrators must invest significant resources to both interpret and develop plans to assure compliance. At J.P. Morgan, our regulatory experts release regular publications on current regulatory topics through our Regulatory Alerts. However, regular updates may not always be sufficient to keep pace with the latest events. Therefore, we invest significant resources to produce more detailed responses to the latest regulatory changes, outlining the likely impact and J.P. Morgan's proposed response. We also regularly host client webinars on such topical issues where the views of our experts are made available to our clients. We place much importance on engaging directly with clients to better understand their concerns and address individual issues.

To further our understanding and impact on the regulatory environment and clarify the intent of the emerging regulatory reforms for our Fund Services clients, we participate in industry groups that are working closely with standard setters. Meetings with the standard setters also provide J.P. Morgan with an opportunity to provide feedback on the impact (cost and effort) that the changes have on our industry that they may not have contemplated. In an effort to leverage the full resources of the firm, our regulatory teams also collaborate with our Corporate Accounting Policy Group. This group monitors and implements regulatory change for J.P. Morgan as a financial institution, asset manager and plan sponsor. As we continue to navigate through new regulatory framework and what it means for our clients, strong partnerships with our clients, service providers and audit firms will be critical to our future success. **MFG**

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Strong Partnerships are Critical to Addressing Regulatory Change

	Key Requirements for Service Providers	What Regulators are Looking for
Asset Managers	<ul style="list-style-type: none">• Provide end to end support and reporting for OTC derivatives• Support prime brokerage integration• Provide accurate valuations and responsiveness to price challenges	<ul style="list-style-type: none">• Independent valuations• Investments within stated guidelines• Clear interpretation of investment objectives• Managing leverage and risk in portfolios
Clients	<ul style="list-style-type: none">• Support for second-source derivatives pricing• Relevant risk and exception reporting• Disclosure language for financial statements• Tax interpretation of market changes	<ul style="list-style-type: none">• Proof of oversight and independence• Risk control framework• Accurate disclosures• Providers who offer comprehensive solutions in response to regulatory changes