SUMMARY

2022 ICI INVESTMENT MANAGEMENT CONFERENCE

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2022 INVESTMENT MANAGEMENT CONFERENCE

Sponsored by the Investment Company Institute

March 27-30, 2022

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ICI President's Address

Speaker: **Eric J. Pan**, President and CEO, Investment Company Institute

Mr. Pan began his remarks by acknowledging the ongoing Russia-Ukraine conflict – a topic that many presenters touched on throughout the conference. He told the story of his recent call with Timur Khromaev, Chairman of Ukraine's National Securities and Stock Market Commission, who had fled to Poland with his family. Mr. Pan said that his conversation with Mr. Khromaev highlighted for him the importance of building investors' trust and confidence in the financial system and helping investors to plan for their futures. He acknowledged that many of the ICI's members were doing this by broadening the scope of their business, developing innovative new products and helping investors manage their savings. With the development of new products and initiatives, he said, comes the need for regulations to adapt and keep pace. Mr. Pan announced that, for this reason, the ICI was launching a comprehensive effort to work with the SEC to adapt the 1940 Act framework to provide the flexibility that modern times require.

Mr. Pan acknowledged that the ICI's new campaign was not the first such initiative to modernize the 1940 Act. He discussed past efforts, including money market fund reform, Rule 12b-1 and other examples where the ICI had worked with the SEC to ensure the 1940 Act was up-to-date. He said the ICI's current effort would focus on simplifying the regulatory structure, seeking to strike a balance where regulations are neither too numerous nor too prescriptive. He explained that the goals of the initiative would include, among others (i) expanding investor access, including retail investor access to alternative investments, (ii) leveraging technology, (iii) enhancing disclosure and board oversight and (iv) empowering investors to access funds at prices they can afford.

The first step in the ICI's campaign, Mr. Pan said, was to conduct a comprehensive study to take stock of the current state of the industry and the expectations of today's investors. He assured the audience that the ICI's process will be thorough and transparent. He said that the ICI intends to present policy proposals to the SEC outlining the ICI's recommendations for enhancement and to work with both sides of the aisle on reforms requiring congressional involvement. Mr. Pan looked forward to working with ICI members on the initiative and, thereby, meeting the needs of current and future investors.

Keynote Remarks: William Birdthistle

Speaker: **William A. Birdthistle**, Director, Division of Investment Management, Securities and Exchange Commission

Director Birdthistle delivered the keynote remarks on the first day of the conference, the full text of which is available here. He began by rejecting the "ominous" title of the December 2021 *Barron's* article published shortly after the SEC's announcement of his appointment: "Fund Critic Birdthistle to Take Reins at SEC's Division of Investment Management." The article described Mr. Birdthistle as "a prominent critic of the fund sector, arguing that the industry is riddled with bad behavior among asset managers." Director Birdthistle disagreed with this characterization, stating that he is a "fund critic" only in that he is "an aficionado of the form and [has] a deep appreciation for seeing it done to the best of its ability."

Returns and fees were a particular focus of Director Birdthistle's remarks. He noted that while some portions of the market enjoy a great deal of movement in response to economic competition, others do not, and he observed that underperforming funds in some cases do not experience the outflows one might expect. Consequently, Director Birdthistle posited that investor vigilance may go beyond the scope of the reasonable investor. He suggested that providing investors with a uniform statement of a fund's individual costs may help investors determine when to exit.

Director Birdthistle also focused on shareholder engagement in the proxy process. He shared his concern that investors may not have sufficient information about how shares of the funds in which they invest are voted. He expressed his support for the SEC staff's consideration of comments on proposals to require streamlined shareholder reports, to amend prospectus fee and expense disclosure, and to enhance the information funds report about their proxy votes.

Director Birdthistle discussed the fiduciary duty that fund advisers owe the funds they manage. He observed that no plaintiff has yet won a case for breach of an adviser's fiduciary duty brought under Section 36(b) of the 1940 Act and questioned "whether the duty enacted in the statute is truly being honored."

In closing, Director Birdthistle expressed "optimism and faith in the power of investment companies" and congratulated the Division's Investment Company Rulemaking Office on the number of

rulemaking initiatives accomplished over the past six months.

Discussion with Senior SEC Division of Investment Management Personnel

Speakers: **Sarah G. ten Siethoff**, Associate Director, Rulemaking Office, Division of Investment Management, Securities and Exchange Commission

Susan Olson, General Counsel, Investment Company Institute

This session was a recorded fireside chat between Susan Olson and Sarah ten Siethoff, taped a week before the conference, covering a number of topics.

Number of Rule Proposals and Comment Period Duration/Overlap. Ms. Olson noted the high volume of recent SEC rule proposals affecting funds and investment advisers, some of which originate outside of the Division of Investment Management. She said that a combination of the complexity and length of some of the proposals, and the number of overlapping comment periods, creates concerns that the industry may not have sufficient time to provide the most helpful input to the SEC. Ms. ten Siethoff acknowledged the volume of rule proposals, but noted that she did not expect changes to the current approach for establishing the duration of comment periods. She said recent practice has been to set a comment deadline of the later of 30 days after publication in the *Federal Register* or 60 days from the relevant SEC meeting. She said that, as a practical matter, comment periods often last longer than 60 days from the meeting date due to the time-frame for publishing the proposals in the *Federal Register*. She also said that commenters are welcome to provide the SEC with supplemental comment letters, and the SEC staff generally looks at comments received after the specified deadline.

Rule 17a-7. Ms. Olson noted the desire for Rule 17a-7 amendments, pointing out that the ICI had submitted a significant amount of member-firm cross trade data along with recommendations for how the rule could be improved, including suggestions to facilitate fixed income cross trades. She noted that this remains an important matter for the industry, notwithstanding that it has dropped off of the SEC's regulatory agenda. She asked what the ICI could do to continue to make progress in this area. Ms. ten Siethoff said that the SEC staff remains concerned about the conflicted nature of cross trades and permitting them in asset classes where there are fewer objective data points available to address those conflicts. She said that the SEC staff had been evaluating how the SEC could become

comfortable that new guardrails were sufficient to expand cross trades beyond the realm of what would be allowed by relying on "readily available market quotations." She invited the industry to provide relevant empirical data regarding the impact of the withdrawal of Rule 17a-7 no-action letters in connection with the compliance date of Rule 2a-5. She also left open the possibility that future rule-making initiatives could contain some "enhancements" related to cross trades.

Money Market Fund Proposal – Swing Pricing for Institutional Prime Funds. Asked why the SEC included uncapped swing pricing and a market impact threshold in the money market fund rule amendments for institutional prime money market funds, Ms. ten Siethoff said that it has become clearer to the SEC that it is costly for those funds to transact during times of stress and those costs should be borne by investors who are requesting liquidity. She acknowledged that the liquidity fee feature of the 2014 rule amendments did not ameliorate this concern during the March 2020 market dislocation for two principal reasons: (i) money market funds did not (and did not want to) invoke liquidity fees and (ii) the triggering mechanism of the liquidity fee structure created the wrong incentives for investors. When Ms. Olson pointed out that it seems like a "blunt instrument" to require swing pricing on *any* day that a fund experiences net redemptions, Ms. ten Siethoff said that the idea was to make swing pricing an ordinary feature of the fund so that it is not something that kicks in only when a fund faces a stressed market. She said the goal was to avoid pre-emptive moves by investors who are trying to beat a threshold being triggered.

Other Topics. Mses. Olson and ten Siethoff also touched on the following topics.

- *Liquidity Risk Management*. Ms. ten Siethoff said that the SEC staff planned to study the impact of the liquidity risk management rule, and that the SEC staff is doing significant data analysis and outreach related to the March 2020 market dislocations to evaluate whether the staff would want to have different tools in similar scenarios in the future and what lessons were learned.
- *Russian Sanctions*. Ms. ten Siethoff said that a team jumped in when sanctions were announced against Russia, and there was significant monitoring and outreach by the analytics office. She said that the SEC staff had significant information available to it, including, as a result of

outreach, identified pressure points in the financial markets and the asset management industry beyond just fund holdings. When asked about the possibility of suspending shareholder redemptions under Section 22(e), Ms. ten Siethoff noted that the SEC does not use that authority lightly. She noted that one factor that could have motivated a suspension order would have been the risk of differentiated harm across a mixed shareholder base where there was the possibility of institutional investors potentially benefiting at the expense of retail investors in a fund.

- *Pending Proposals*. Ms. Olson stressed that e-delivery is still an important priority for the ICI. Ms. ten Siethoff noted disclosure reform is still on the agenda, and the industry should "stay tuned" as the proposal received a lot of positive feedback. Ms. ten Siethoff also agreed that the world has moved further toward digital communications. She noted the SEC's desire to assure that digital communications between funds and shareholders are done thoughtfully, noting that it may be easy to default to electronic delivery, but that some of the details can be tricky to implement (*e.g.*, at what point is a consent to use an old email address too old?), and it is important to pay attention to what is going on in the technology space when it comes to digital communications.

- *Climate Change Risks Rule Proposal.* Ms. ten Siethoff encouraged fund groups to provide feedback on the rule proposal from the Division of Corporation Finance regarding public company disclosure. She noted that any fund-focused ESG rule from the Division of Investment Management would have a different, broader focus than just climate.

WHAT'S HAPPENING IN DIFFERENT STROKES: TRENDS IN SPECIALIZED PRODUCTS

Moderator: **Kenneth Fang**, Associate General Counsel, Securities Regulation, Investment Company Institute

Speakers: **Christian Clayton**, Executive Vice President, PIMCO Funds

Hugh Farrish, Head of Americas ETF Product, JP Morgan

Jennifer R. Gonzalez, Partner, K&L Gates LLP

Eric S. Purple, Partner, Stradley Ronon Stevens & Young, LLP

This panel explored developments in ETFs, CEFs (including exchange-listed closed-end funds, interval funds and tender offer funds) and other investment vehicles. Mr. Farrish noted that ETFs represented 26% of the combined assets under management of long-term open-end mutual funds (excluding money market funds and funds of funds) in 2021, up from 18% in 2016. He said that inflows of over $1.1 trillion to this market in 2021 were overwhelmingly driven by inflows of almost $800 billion to passive ETFs, but that inflows to active ETFs had the highest growth rate, albeit from a small asset base. He attributed this in part to a decrease in barriers to entry in the ETF market and the fact that ETFs were easier to distribute internationally. Mr. Clayton noted that over the last four years, assets under management in listed CEFs had increased from approximately $250 billion to approximately $300 billion, and assets under management in interval/tender offer CEFs had increased from approximately $50 billion to approximately $100 billion. He said growth in the market was driven in particular by investors seeking income.

ETFs. Mr. Farrish classified the ETF market into five segments. He said that there are two basic segments, (i) market cap and (ii) strategic beta, which he noted were huge categories (representing about 96% of the ETF market) but with slowing growth, and three specialized segments, (iii) active, (iv) ESG and (v) thematic, currently small in size but with high organic growth rates. Mr. Farrish noted that the market for active products improves where it was possible to hedge the strategy. Mr. Purple said that the adoption of Rule 6c-11 was a game changer, largely leveling the playing field, diminishing many of the previous distinctions among ETFs and making it much easier for new entrants to reach the market quickly. Mr. Farrish commented on the conversion of mutual funds to ETFs, noting the importance of (i) the client experience and limiting disruption (*e.g.*, it can be disruptive to a defined contribution plan if the plan can hold a mutual fund but not an ETF), (ii) confirming that client platforms can handle ETFs and conversions and (iii) the ETF offering some client benefit (*e.g.*, a reduction in fees). Mr. Purple said that most conversions are "shell reorganizations," requiring the fund board to determine that the conversion is in the best interest of mutual fund shareholders.

Mr. Farrish commented on thematic ETFs, stating that breakthrough technology and innovation strategies were currently enjoying

the greatest market success. Mr. Purple said that thematic ETFs often have to contend with the names rule, and that distinguishing concepts from industries could be challenging.

Listed CEFs. Mr. Clayton reviewed the listed CEF market, noting the IPO boom in 2012 and 2013 that was followed by a lull until IPOs picked up again starting in 2019. He attributed the high levels of assets raised since 2019 to changes in the CEF structure. He said that (i) now sponsors, instead of investors, pay financial adviser commissions, (ii) now sponsors pay the underwriting/structuring fees, instead of sharing this burden with investors, (iii) CEFs now generally have a limited term (*e.g.*, twelve years, subject to potential extension) instead of a perpetual term and (iv) CEFs now, at the end of their term, can offer a voluntary tender offer to investors with an option to convert to a perpetual term product. Ms. Gonzalez said that, previously, investors had been disinclined to invest in IPOs because of the fees that they would bear, which tended to result in smaller funds being raised. Now, she said, the sponsor generally bears more of the risks associated with earning revenue from CEFs, including (i) incurring fees relating to the IPO, (ii) identifying the correct investment strategy at the right time, (iii) facing activists and (iv) having a limited term, which means that there are fewer years during which the fund can be profitable to the sponsor. Mr. Clayton said that that there had been significant growth in thematic equity CEFs. He said that it could be a challenge for sponsors, who generally like funds with flexible mandates, to differentiate their offerings in the market. Ms. Gonzalez noted that, especially in the area of ESG funds, the SEC staff often requires funds to restrict flexibility so as to comply with the names rule.

Interval and Tender Offer CEFs. Mr. Clayton distinguished interval and tender offer funds from listed funds, noting in particular that (i) interval and tender offer funds do not have traditional underwritten IPOs, (ii) there is no secondary market for these funds' shares and (iii) the lack of a secondary market means that there is no discount to NAV for activists to exploit. He said that tender offer funds have somewhat more flexibility in terms of liquidity than interval funds. However, he said, interval funds are generally easier for investors to access, because they do not require the subscription agreements typical of tender offer funds. He said that, since the great financial crisis, investors have been more understanding of longer-term, less-liquid investment products. However, he added,

interval funds have not yet been tested by high demand for outflow.

Other Investment Products and Predictions. The panel concluded with a brief discussion of CITs. Ms. Gonzalez noted that they are quick to market. Mr. Purple noted the possibility that the SEC staff may conclude that, if CITs become widely available, they are being used beyond the intent of their exception from the definition of an "investment company." The panelists said that they believed ETFs would continue to grow, with active ETFs eventually representing 10% to 20% of the market. They also believed that there would be continued growth in CEFs (and REITS and BDCs). However, Mr. Purple cautioned that FINRA's recent proposed rule on the sale of complex products to retail investors had the potential to disrupt sales practices with respect to interval and tender offer funds as well as other products.

The Fund Board Perspective on Regulatory and Industry Developments

Moderator: **Thomas T. Kim**, Managing Director, Independent Directors Council

Speakers: **Kathleen T. Barr**, Independent Director, William Blair Funds and Professionally Managed Portfolios

Christopher E. Palmer, Partner, Goodwin Procter LLP

Rana J. Wright, General Counsel, Harris Associates, Interested Trustee, Oakmark Funds

Current Focus Areas for Fund Boards. Panelists identified several topics that are current areas of focus for investment company boards, including (i) compliance with new SEC rules, (ii) the "great resignation" and the adequacy of the workforce, (iii) adapting to employees' return to the office and (iv) the need for fund boards to understand the adviser's business strategy (recognizing that the fund board does not set the adviser's strategy). Ms. Barr said that fund boards should adopt a posture of "noses in, fingers out" with respect to the adviser's business strategy. Mr. Palmer suggested that, if a board makes clear that it understands that its role is not to set strategy for the adviser, the adviser may be more willing to share its strategy more fully with the board.

The panel discussed preparations for compliance with the SEC's new valuation rule (Rule 2a-5 under the 1940 Act). Ms. Barr expressed the expectation that many fund groups are not likely to need to make significant changes in their valuation practices in order to comply with the rule, but that

related documentation (valuation policies, board reporting formats, etc.) are likely to change somewhat. Mr. Kim noted that the rule requires both annual and quarterly reporting to the board, as well as "prompt" reporting following the occurrence of certain specific valuation-related events. Mr. Palmer observed that the new rule provides helpful clarification of where the responsibility for oversight of pricing services lies, noting that the "valuation designee" appointed by the board has that responsibility. He said fund boards should, however, seek to understand the oversight approach that the valuation designee is taking with respect to the pricing services it uses.

The panel discussed the SEC's recent proposal of new rules regarding cybersecurity risk oversight for registered investment companies and investment advisers (Rule 38a-2 under the 1940 Act and Rule 206-4(9) under the Advisers Act). Ms. Barr noted that Rule 206-4(9), as proposed, would require investment advisers to adopt and implement cybersecurity risk management programs that encompass private funds managed by the adviser and third-party service providers, as well as the adviser itself. Ms. Wright stated that many large advisers already rely on prepared "playbooks" that lay out steps that would be taken in the event of various types of cybersecurity incidents. Mr. Palmer said that investment companies and their advisers have a shared interest in avoiding serious cybersecurity problems, but that investment company boards nevertheless should inquire into the adequacy of the resources the adviser devotes to cybersecurity risk prevention, detection and management.

Diversity and Inclusion. The panel discussed the importance of diversity and inclusion on investment company boards and in investment advisers' workforces. Ms. Barr said that a key to achieving a diverse board is being intentional about recruiting diverse candidates and developing a pipeline of diverse candidates in anticipation of future openings on the board. One panelist also expressed the view that, in recruiting new board members, boards should look primarily for candidates who have inquiring minds rather than for candidates chosen for a specific, narrow professional background (*e.g.*, cybersecurity). Ms. Wright observed that a diverse fund board can model diversity for the adviser and its workforce. The panel discussed the practice that many fund boards have established of requesting information regarding the adviser's and other fund service providers' workforce diversity and inclusion practices and policies. Mr. Kim noted that the Independent Directors Council is planning

future initiatives to help foster a more diverse community of fund directors.

Areas of Innovation. Mr. Kim invited each panelist to identify areas of innovation in the work of investment company boards. Ms. Wright cited an interest in better understanding the needs of fund investors, including those investors who buy and hold fund shares through intermediaries rather than directly. She noted that individual investors increasingly have access to an adviser's services through a variety of "wrappers," including not only mutual funds, but also collective investment trusts for employee benefit plans and separately managed accounts. Ms. Barr said that fund boards should seek to understand the extent to which investors are migrating from mutual funds into other products managed by the adviser, and the mechanics through which such transfers occur (*e.g.*, redemptions in kind), as well as the tax consequences of these transfers for the mutual fund and its shareholders.

Mr. Palmer emphasized the need for fund boards to receive appropriate education to enable the board to exercise appropriate oversight of fund operations and the relationship between the fund and the adviser. He said that management and outside counsel can be helpful in educating board members. He also said that it is important for board members to understand where the economic incentives for the adviser and its personnel lie, so that the board can identify and monitor areas of potential conflicts of interest.

ESG Investing. The panel briefly discussed the incorporation of ESG factors in managing investment company portfolios. Mr. Palmer highlighted the need for fund boards to understand the adviser's approach to the application of ESG factors in its investment process. Ms. Wright observed the current absence of clear, widely accepted metrics and standards for ESG investing. Ms. Barr emphasized the importance of board members participating in continuing education programs relating to relevant topics including ESG investing.

KEYNOTE REMARKS: NATASHA CAZENAVE

Speaker: **Natasha Cazenave**, Executive Director, European Securities and Markets Authority (ESMA)

Ms. Cazenave opened her remarks by noting that ESMA is a strong supporter of international cooperation and the goal of reaching international consistency, wherever possible. She discussed two areas of focus for ESMA in 2022: (i) developing a framework for

the asset management industry to positively contribute to climate-related matters and (ii) strengthening the resilience of funds to market, credit and resiliency shocks.

Climate-Related Matters. Ms. Cazenave stated that the disclosure requirements in the EU's Sustainable Finance Disclosure Regulation (SFDR), which have applied since March 2021, are a key building block of ESMA's framework. She said the disclosure requirements are intended to enhance investor confidence and support ESG market growth in a sound environment. She noted that the industry continues to prepare for compliance with the remaining SFDR requirements, which will take effect in January 2023. She reported that the relevant EU supervisory authorities are in the process of preparing for review of the SFDR indicators, a key part of the SFDR disclosures, for "principal adverse impacts." She explained that the supervisory authorities are responsible for ensuring that the indicators remain relevant in light of scientific and environmental developments. She noted that, although SFDR was intended to be a "transparency regulation," the industry and investors are increasingly treating it as a means of classifying products and, in the case of the industry, marketing products as ESG products. She then commented on the taxonomy regulation, noting that the taxonomy is still developing and ESMA is trying to provide practical guidance where possible. She noted that the supervisory authorities were challenged in their supervisory duties due to the fact that they lack sufficient data about products advertised as "sustainable" in the market. She observed that sustainability considerations are transforming the fund industry and stated that ESMA always welcomes feedback from market participants.

Financial Resiliency. Ms. Cazenave stated that ensuring orderly and stable markets is at the core of ESMA's mission. She discussed the role of money market funds, noting that the market volatility experienced in March 2020 demonstrated money market funds' vulnerabilities. She reviewed ESMA's three key proposals regarding money market funds: (i) removing the possibility of amortized cost for low volatility net asset value money market funds, (ii) decoupling regulatory thresholds from suspensions, gates and redemption fees for certain money market funds, and (iii) increasing daily liquid asset and weekly liquid asset ratios for certain money market funds. She then discussed ESMA's review of the AIFMD, noting that ESMA hopes to increase and harmonize the liquidity tools available to fund managers

across European jurisdictions. Ms. Cazenave concluded by stating that ESMA will continue its efforts to ensure that supervisory authorities have the right tools and data to oversee the market risks.

Legislative Outlook in a Pivotal Election Year

Moderator: **Kathleen L. Mellody**, Senior Government Affairs Officer, Investment Company Institute

Speakers: **Andy Blocker**, Global Head of Public Policy and Head of US Government Affairs, Invesco Ltd.

Michelle Y. Mesack, Managing Director, Head of Federal Government Relations, J.P. Morgan Chase & Co.

The session began with a discussion of the current state of Washington, DC politics, including whether the political climate was as contentious as portrayed by news outlets. Mr. Blocker observed that while the contentiousness is real, it is often overemphasized by news outlets. Ms. Mesack added that politicians reflect their constituents, and that as more districts become "hard red" or "hard blue," politicians feel pressure to take more polarized views.

The panelists discussed the outlook for the Build Back Better Act. Mr. Blocker explained that while many of the Act's components are popular, collectively they are very expensive and, therefore, the Act as a whole is less popular. He noted that it is not enough to have good policy, and that "good politics" is also necessary to win passage. Ms. Mesack added that it is hard to get anything done in an election year, and that passing something as transformational as the Build Back Better Act with slim Congressional margins is especially challenging. Mr. Blocker noted that there are a few proposals with bipartisan support that could be approved in an election year, including proposals to enhance US competitiveness with China, the Secure Act 2.0 and the Postal Service Reform Act. He stated that the top Democratic priorities in the coming months also included confirmations and passing budgets.

Ms. Mellody asked the panelists to discuss how the asset management industry is viewed in Washington, DC. Mr. Blocker observed that the industry was not viewed as negatively as some other industries, such as banking, but that it was hard to get Congress' attention on asset management-related issues unless they impact "real people" (*i.e.*, individuals other than wealthy investors). Ms. Mesack noted that the ICI was viewed as a very credible institution on Capitol Hill.

The panelists agreed that proposals to tax wealth or unrealized gains were unlikely to pass in the coming year. Ms. Mesack added that a possible change in tax treatment for ETF distributions in-kind was also off the table, at least for the time being.

The panelists discussed the likelihood that control of the House and/or Senate would flip in the 2022 elections, and the related implications for the asset management industry. Ms. Mesack and Mr. Blocker noted that, at least based on current indicators, control of the House appeared likely to flip to Republicans, and control of the Senate was viewed as a toss up. They agreed that inflation and the economy were key factors that would shape the November elections. If full control of Congress shifts to Republicans in November, Ms. Mesack believed that it was unlikely Republicans would be able to pass a Republican-oriented agenda, but that it would trigger a change in control of committee gavels. In addition, in the case of the Senate, she indicated, Republican control likely would force more moderate nominations for judges and other positions requiring Senate confirmation.

The panelists also addressed a number of questions from the audience. In response to a question about the likely timetable for filling the two SEC commissioner vacancies, the panelists agreed that, because there was one Democratic vacancy and one Republican vacancy, the two positions were likely to be paired and approved reasonably quickly.

Thinking Outside the Box: Innovations in Financial Offerings for Retail Investors

Moderator: **Bridget D. Farrell**, Assistant General Counsel, Securities Regulation, Investment Company Institute

Speakers: **Marian Fowler**, Partner, Kirkland & Ellis LLP

Kristen Freeman, Senior Director and Counsel, ProShares

Richard C. Sarhaddi, Chief Compliance Officer, Just Invest LLC, Vanguard

Alison Staloch, Chief Financial Officer, Fundrise

Ms. Farrell began the panel by discussing the SEC's focus on financial products aimed at "retail investors," noting that there is no standard definition of this term. Mr. Sarhaddi said that Vanguard thinks of retail investors as including individual and IRA investors. Ms. Fowler agreed there is no single regulatory definition, but described several regulatory concepts that could be instructive, including (i) Regulation Best Interest, which focuses on individuals who receive information for

investment purposes—the assets and income of the individual are not relevant and (ii) the definitions of "accredited investor" under the Securities Act, "qualified purchaser" under the Investment Company Act and "qualified client" under the Investment Advisers Act, each of which includes asset- and/or income-based tests.

Accessing Retail Investors. Mr. Sarhaddi said that the ability to scale technology to access and serve retail investors is relatively new, using as an example advances that have allowed financial advisors to offer "direct indexing" to smaller accounts. Ms. Staloch said that younger retail investors want information and advice delivered to them differently—accessible on their smartphones, with instant access and direct communication.

The panel discussed the importance of involving legal and compliance teams in efforts to develop and enhance technology platforms. The noted that the compliance team needs to understand what is being developed and how it is being used during the process, otherwise a system might be built only to discover that it has compliance issues once finished. For example, they explained that system developers may want to develop simple and attractive user interfaces, but the securities laws may require disclaimers, "click-throughs" and other items that need to be incorporated into the system. Competing priorities like these, the panel noted, can be addressed by having the technology and compliance functions coordinate throughout the buildout process so that each understands the requirements of the other. The panelists also discussed the importance of testing the system after completion and prior to implementation to confirm that it provides the described functionality. The panel also discussed the SEC staff's 2017 guidance on "robo-advisers."

Ms. Fowler discussed products that could be used to offer private market/alternative investment opportunities to retail investors, including interval funds, closed-end funds that invest in private equity, business development companies, parallel vehicles for non-knowledgeable employees of alternative managers and SPACs. Ms. Staloch explained that Fundrise had started by offering products pursuant to Regulation A of the Securities Act, but that size limitations on these offerings led Fundrise to sponsoring registered interval funds instead.

Recent FINRA Request for Comment. Ms. Freeman discussed the recently issued FINRA Regulatory Notice 22-08, which solicits comment on possible new restrictions on the sales of "complex products" to retail investors. She said that, although issued as a

request for comment, conceptually, the Notice signals a departure from a disclosure-based regime. For example, FINRA requests comment on requiring a "knowledge check" (*i.e.*, test) of retail investors before permitting them to invest in complex products, and suggests possible limitations on self-directed (*i.e.*, execution only) trades. She also said that FINRA's list of "complex products" was very lengthy and could include interval funds, defined outcome funds, global real estate funds, funds that used derivatives (even if for hedging) and many other products that are not necessarily thought of as "complex."

Accessing Cryptocurrency Investments. Ms. Freeman said that there was a tremendous retail interest in bitcoin and other crypto investments and described different ways in which retail investors could access crypto investments. She discussed some of the advantages of investing through a pooled investment vehicle, as well as the limitations the SEC has placed on accessing crypto investments through registered vehicles. Ms. Fowler noted that the SEC, the Biden Administration and Congress are all very focused on crypto investments, suggesting the possibility of regulation and/or legislation from a variety of sources. She also discussed some of the regulatory issues associated with cryptocurrency, such as whether it is a security, how it should be custodied, valued and audited, as well as personal trading issues.

Direct Indexing. Mr. Sarhaddi discussed direct indexing, which involves a retail account owning an index's constituent securities directly rather than through an index fund. He said direct indexing allows for individualized adjustments to the index (*e.g.*, for ESG considerations) and enhanced tax management.

Diversity and Inclusion Keynote Remarks: Julia Taylor Kennedy

Speaker: **Julia Taylor Kennedy**, Executive Vice President, Coqual

Ms. Taylor presented Coqual's research on how managers can reinforce inclusive practices and behaviors in their organizations. She began with a history of diversity, equity and inclusion efforts and explained that, broadly speaking (i) diversity addresses representation, (ii) inclusion addresses individual behaviors, (iii) belonging focuses on building empathy, and (iv) equity is about processes, systems and rules. She stated that this four-pronged approach is key to promoting effective practices and culture within an organization.

Ms. Taylor focused in particular on the concept of equity and provided advice on

how to achieve equity in areas such as resource allocation, performance evaluations, promotions and pay practices. She explained that equity is not the same as equality – the goal of equity is to achieve fairness in outcomes, not simply to treat everyone the same.

Ms. Taylor then shared a number of facts and statistics from Coqual's research, examining how different groups (*e.g.*, Latinx men, Black women) expressed their perception of different practices. She also discussed the state of pay and promotion equities, including theories regarding a "motherhood tax" and a "fatherhood bonus."

Warp Speed Rulemaking: ESG, Proxy Matters, Disclosure Reform

Moderator: **Dorothy Donohue**, Deputy General Counsel, Securities Regulation, Investment Company Institute

Speakers: **Lance C. Dial**, Partner, Morgan, Lewis & Bockius LLP

Bob Grohowski, Managing Counsel, Legislative and Regulatory Affairs, T. Rowe Price Associates, Inc.

Peter G. Reali, Managing Director, Head of Stewardship—Responsible Investing, Nuveen Fund Advisors, LLC

Introduction. Ms. Donohue opened the panel by noting the current unprecedented pace of rulemaking coming from the SEC. She described the shortened comment periods associated with such rulemakings and recent appointments by Chair Gensler within the SEC that will influence rulemaking in the months to come. She highlighted that, at the time of the panel and since the appointment of Chair Gensler, the SEC had issued 25 proposals, with comment windows shortened from a range of 60-90 days from the date of inclusion in the *Federal Register* to 60 days from the date of posting online.

Ms. Donohue explained that the panel would focus primarily on three themes in recent rulemaking and three specific disclosure proposals. She said that thematically the SEC's rulemaking can be categorized into three buckets: market resiliency, funds/advisers and market disclosures. Within these buckets, she said that the panelists would discuss (i) ESG proposals and public company climate-related disclosures, (ii) modernization of fund proxy-voting disclosures and (iii) fund disclosure reform. The panelists introduced themselves and commented briefly on the pace of rulemaking.

Mr. Dial cautioned that the themes highlighted by Ms. Donohue each present

critical issues, and that addressing them all at the same time may make it difficult to allot each proposal the appropriate time and consideration necessary to provide constructive commentary. Mr. Grohowski agreed and noted that much of the recent rulemaking has emphasized real-time reporting and disclosure. He said that, while it may be technologically possible to provide real-time information to the market, extreme transparency may not be in the best interests of long-term investors and that this issue must be carefully considered.

Mr. Reali concurred that the rulemaking agenda has been ambitious, but applauded the SEC for addressing many of the large systemic issues facing the industry.

ESG Proposals. Ms. Donohue asked the panelists to discuss the ESG proposals that may impact the industry. Mr. Dial discussed the regulatory landscape for ESG matters, noting as an example the lack of a consistent message from the Department of Labor regarding ESG. He also stated that the SEC staff has, in examinations, expressed the view that ESG may be a particular type of investment or investments rather than a strategy, which would have broader implications for fund disclosures.

Mr. Grohowski addressed the sequencing of regulation in the ESG space. He explained that, in order for an investment adviser to provide comprehensive ESG reporting, it will need to have received certain data from the companies in which it invests. If the SEC were to simultaneously mandate disclosure at the adviser and company level, there would likely be data gaps where insufficient underlying data is available to meet reporting requirements. Mr. Dial agreed, noting that the release of the public company climate-related disclosure proposal seems to signal a recognition by the SEC of the importance of this sequencing.

Ms. Donohue asked the panelists for their views regarding what funds and advisers may be expected to report. Mr. Grohowski noted that, in other jurisdictions, the industry is seeing requirements at the adviser level to make disclosures regarding their investment process, the "tone from the top" regarding ESG matters, portfolio risk management and stewardship of investment targets, but is not seeing requirements to disclose specific metrics, unless the adviser has publicly committed to specific goals that can be tracked with metrics. He said that, at the fund level, we are seeing narratives, but also core metrics that allow tracking of, for example, carbon footprints, and he also described

heightened disclosure requirements applicable when a fund holds itself out as ESG-focused.

Mr. Grohowski explained that the Task Force on Climate-Related Financial Disclosures (TCFD) framework—cited in the public company climate-related disclosure proposal—includes both a quantitative and qualitative analysis that, if required at the fund level, may implicate rules regarding predicting fund performance. He cautioned regulators to carefully consider whether the same requirements that work in an operating company context can be mapped onto fund disclosures without unintended consequences.

Mr. Reali emphasized the timeliness of disclosure requirements, noting the increasing pressure from clients to have access to this type of information, even with respect to products that are not ESG-branded.

Public Company Climate-Related Disclosures. Ms. Donohue turned the panelists' attention to the recently released public company climate-related disclosure proposal, noting its applicability to public companies and business development companies (BDCs) but not to registered funds.

Mr. Dial provided a summary of the rule, explaining that it would require narrative disclosure regarding climate-related risks, largely based on the TCFD framework, including physical risks and those related to conversion to less climate impactful operations. He also discussed requirements related to Scope 1, Scope 2 and Scope 3 greenhouse gas emissions, noting the multi-year phase-in process that will be required to manage the scope of data required.

Mr. Grohowski said that the TCFD discusses disclosure as a "journey," but commented on the difficulty of that approach in a regulated industry. He also noted that, although the SEC proposals would prohibit required disclosures when there are data gaps or mechanics that make the information misleading, navigating how and when to rely on this carve-out would be challenging. Mr. Reali agreed, emphasizing the importance of accepting the idea that it will be a complicated undertaking to compile and audit information responsive to the requirements. Nonetheless, he noted that, if companies are required to provide data in a uniform manner, investors in those companies will be able to access and compile such data more efficiently.

In response to a question from Ms. Donohue, the panelists discussed the

litigation risks faced by any proposed rules in the ESG space. Mr. Dial noted that the climate-related disclosure rule would be subject to Administrative Procedure Act claims. He said that litigation may address the authority of the SEC and whether the proposals align with the SEC's three-part mission, as well as whether they violate the First Amendment.

Modernization of Fund Proxy Voting Disclosures. Mr. Dial summarized certain proposed changes to Form N-PX that would simplify the disclosure regarding how a fund voted proxies, including requiring that the disclosure must be machine-readable for data aggregators. He noted that the proposal would require a fund to disclose the number of shares on loan that are not recalled to be voted. Messrs. Reali and Dial discussed the challenge of determining how to weigh the value of lending shares against recalling and voting. Mr. Grohowski agreed that the disclosures seem to carry an implicit, but problematic, notion that securities lending is somehow inconsistent with shareholder interests. Mr. Dial agreed, noting that the required disclosures might chill securities lending more broadly.

Fund Disclosure Reform. Ms. Donohue briefly discussed the August 2020 fund disclosure annual report proposal, noting that a final rule is expected in October. She explained that, among other things, the proposals would eliminate Rule 30e-3, modernize and shorten shareholder reports and provide funds the option to discontinue mailing annual prospectuses to current shareholders under certain circumstances.

Mr. Dial again emphasized the seismic shift represented by various proposals to require real-time data. This will have profound effects on how funds think about and report data.

How to Set a Table: An Exercise in Risk Mitigation

Moderator: **Peter Salmon**, Senior Director, Technology & Cybersecurity, Investment Company Institute.

Speakers: **John Ansbach**, Vice President, Stroz Friedberg

Mike Catlin, Head of Technology Services and CISO, Capital Group

Christopher Wilson, Board Chair, Invesco Funds

This panel conducted a "live" tabletop exercise in which the panelists analyzed and responded to an attack scenario as it evolved and grew increasingly complex. Topics addressed included when and how to involve

the board, outside counsel, law enforcement, insurance carriers and the media. The goal of the exercise was to identify roles, responsibilities and escalation protocols.

Scenario 1. RedPanda666 email to U.S. transfer agent from an unknown sender—I have your data. Press link.

Mr. Catlin noted that receipt of an email like this should trigger investigation by the internal security team but would likely not be further escalated at this stage. Such an investigation should consider whether the firm has previously received emails from the same sender and whether the recipient clicked the included link, which could result in the download of ransomware to the system. Mr. Ansbach noted that outside counsel would not be involved at this stage, and Mr. Wilson added that the Board would not typically be notified at this point. He explained, however, that the Board should understand, prior to any incident, what management would do in situations like this, what the escalation protocols in place are, what insurance arrangements are in place and what the role of the CCO would be. Ideally, the Board has periodic meetings with IT professionals to understand, for example, the systems and resources available in the event of a breach.

Scenario 2. Second email with "proof of life." I still have your data. I am serious about the data I have. Provides a sample. Only 69 hours to pay. Shows investor names, Social Security numbers, bank account and routing number.

Mr. Catlin explained that a follow-up email such as this ratchets up the response because the threat actor seems to have data. He said that at this stage, he would involve the legal department, communications team and the insurance carrier. Mr. Ansbach suggested that, in addition to those parties identified by Mr. Catlin, outside counsel should also be involved as well as a cyber-carrier who may bring in a data breach coach (*i.e.*, a law firm that specializes in data breaches) and a forensic investigator to support the internal IT team. He said that it is also a good practice to reach out to law enforcement through pre-established relationships. Mr. Wilson said that he would expect that, in many firms, the Board and Audit Committee chairs would be informed of the receipt of the email. The chairs should be informed of the facts, the steps being taken and the resources being used.

After the appropriate parties have been involved, Mr. Catlin said that a forensic examination should seek to understand what file systems the data came from and who had

access to those systems, and that any accounts identified in the email should be monitored for activity. Mr. Ansbach suggested that engaging with the threat actor can be helpful at this stage and can be managed by a third-party negotiating firm. Communications would include self-serving statements because of anticipated litigation, such as "our shareholder records are very important to us." These communications with clients are done pursuant to attorney-client privilege, but Mr. Ansbach noted that the law is "squishy" around attorney-client privilege, and so the firm should work closely at the direction of outside counsel to protect the communications as much as possible.

Scenario 3. The transfer agent (TA) discovers that a service desk employee has been absent for the last two days and that files the employee handles include three investors' names sent by the threat actor. The employee's file had 3,000 names. Also, one of the three investors has now tweeted that the TA has been hacked and is warning people on Twitter.

Mr. Catlin noted that the firm still does not know the extent of the actual breach and suggested that the focus of the investigation is now on the system where the file resides to determine if there is any irregular activity. Mr. Ansbach also suggested that the investigation consider dark web monitoring and threat intelligence work, including with respect to the employee. He also suggested reaching out to the tweeting investor, explaining that an investigation is underway and that a forensic analysis has not yet confirmed the scope or method of breach. He also noted that the Board should be provided with an update. Mr. Wilson noted that the Board may determine to hire a consultant at this stage.

Scenario 4. The employee shows up at work. It turns out that she had a medical emergency, and had downloaded and printed data as part of an assignment. She had sent a text to her supervisor but only now notices that the text was never received. The firm is receiving media inquiries, asking whether TA has been hacked.

Mr. Catlin noted that the investigation should address the new information from the employee, including whether the printed information may have been the source of the breach. Mr. Ansbach explained that outside counsel should be consulted as to next steps with the employee and that the public relations firm should be consulted regarding external messaging. He noted that deadlines are often malleable, as long as you continue to engage with the threat actor, but that there are no guarantees. Negotiation can sometimes help to stretch out the

conversation while law enforcement, forensics and public relations are doing their jobs, but, he added, sometimes the business team will decide to make the payment to put an end to the potential exposure.

Scenario 5. Resolution. The FBI and others collect evidence that implicates the cleaning staff and are able to take down the threat actor.

Mr. Catlin explained that at the conclusion of an incident, a firm should do an internal post-mortem. He also recommended notification to the broader pool of investors to provide assurances and explain steps taken by the firm to protect investors. Mr. Wilson suggested that the Board CCO, as well as internal audit, can help analyze how the incident was handled, and the public relations team can help to ensure good and effective communication.

Fund Industry Civil Litigation: Year in Review

Moderator: **Julia Ulstrup**, Senior Vice President and General Counsel, ICI Mutual Insurance Company

Speakers: **Eben P. Colby**, Partner, Skadden, Arps, Slate, Meagher & Flom LLP

Sean M. Murphy, Partner, Milbank LLP

Abigail Murray, Managing Counsel, Janus Henderson Investors

Fee Litigation Under Section 36(b). The panel began by discussing the current status of excessive fee litigation under Section 36(b) of the 1940 Act. Mr. Murphy expressed optimism at "seeing the light at the end of the tunnel" of traditional 36(b) litigation with no new cases filed in nearly five years and no cases currently pending. The final case in the recent wave of litigation concluded when the Tenth Circuit Court of Appeals affirmed the district court's trial opinion in favor of GreatWest in July 2021. The court's opinion in the GreatWest case highlighted once again the difficult burden plaintiffs face in 36(b) litigation. Specifically, the court rejected plaintiffs' criticism that the board did not adequately negotiate with the adviser in approving fund fees; rather, the court held that asking questions of the adviser and engaging in a dialogue about fees is a form of negotiation. Mr. Murphy concluded that the law is very settled now in this area and that board process remains the critical factor, noting that courts are reluctant to upset the informed business judgment exercised by the board, and the key considerations include whether the board asked questions, whether they engaged outside consultants and experts, and whether they pressed back on

the adviser from time to time. In response to this, Ms. Murray confirmed how heavily her firm relies on service providers, including fund and trustee counsel to assist the board with their oversight responsibilities.

Mr. Colby noted that the single 36(b) case recently filed was against a SPAC. There, the plaintiffs have argued that for a certain period of time before it acquires a start-up company, the SPAC was effectively acting as an investment company investing in securities and, therefore, is required to engage in a 15(c) process and approve fees consistent with the standard established under Section 36(b) of the 1940 Act. The case remains pending.

The panel discussed their expectation of what is to come for 36(b) litigation. Mr. Murphy expressed confidence that this last wave of manager-of-managers and subadvised fund cases is over but expressed concern and offense at Director Birdthistle's remarks from the prior day in which the Director questioned whether Section 36(b) is truly being honored given that no adviser has ever been found to be in violation of it. Mr. Murphy queried whether Director Birdthistle was suggesting there are additional ways to attack advisory fees through the use of the SEC's tool box, such as breach of fiduciary duty or loyalty claims, but concluded that such an attack would be a difficult one for the SEC to pursue and establish. He did highlight a distinction to be aware of, which is that while civil plaintiffs are not incentivized to challenge high fees charged by small funds, the SEC does not have an interest one way or another about the size of the fund at stake and so may focus on smaller funds with higher fees. In the end, Mr. Murphy reiterated that he remains confident that the settled authority underlying Section 36(b) still stands in the SEC's way.

Prospectus Liability/Disclosure-Based Litigation. The panel discussed prospectus liability and disclosure-based litigation, which has remained relatively quiet. Mr. Murphy noted a case filed against an adviser recently in California for having an allegedly misleading prospectus by charging active management fees for what is effectively an index fund. The plaintiffs voluntarily dismissed that case, likely realizing it was not based on a solid legal theory. Although litigation in this space has been quiet, claims under the 1933 Act remain attractive to plaintiffs since they can point to an evergreen prospectus with a strict liability standard that can be filed in (and not removed from) state court. Since the Supreme Court's ruling in *Janus*, the defendants in these types of cases primarily focus on the directors who signed the registration statement, and the adviser

based only on a control person theory of liability.

Mr. Colby noted that the types of defenses asserted in these cases depend on the nature of the product, explaining that it can be difficult to establish loss causation for an open-end mutual fund whose share price is determined by its daily established NAV (*i.e.*, the market price of the underlying portfolio securities), not by investor sentiment about the fund itself. Separately, there are standing requirements that require plaintiff shareholders to trace the purchase of their shares in the fund to the actual prospectus with the alleged misstatement, which can be very difficult for a shareholder in an ETF or closed-end fund to do. Finally, it was noted that the director defendants have an affirmative defense of having conducted adequate due diligence of the disclosures, though only after the motion-to-dismiss stage. Ms. Murray emphasized the need for a robust disclosure process including making sure that the appropriate subject matter experts have weighed in and sign-off has been obtained from counsel.

Finally, in response to Ms. Ulstrup's question about areas that may raise issues in disclosure liability in the near term, Mr. Colby anticipated that those areas are likely to include (i) ESG, (ii) cybersecurity and (iii) crypto issues.

Litigation Under State Law. Mr. Colby discussed the high level of litigation in recent years arising from activist investors in closed-end funds. Activists seek to invest in closed-end funds trading at a discount to NAV, build a significant concentration in that fund, and then seek to initiate a governance change that allows the activist to force a liquidity event, upon which the activist is able to arbitrage the trading price closer to NAV. Certain defense measures have been taken by boards to ensure that significant changes to a fund, such as new board members, are fully supported by a large portion of the fund's shareholders and not just the concentrated minority shareholder activist. By-law amendments that have been challenged by activists include (i) advance notice requirements for proposals at shareholder meetings, (ii) imposing more stringent trustee qualifications, (iii) changing the voting standard applied in a contested trustee election and (iv) control share provisions that restrict a shareholder's ability to cast his or her vote once they achieve a certain percentage of ownership of the fund (*e.g.*, 10%), unless a majority of the remaining shareholders consent. Prior to May 2020, the SEC staff had taken the position that control share provisions violate the "one share/one

vote" requirement of Section 18(i) of the 1940 Act. However, in May 2020, the SEC staff withdrew its prior position and stated they would no longer seek an enforcement action if a closed-end fund opted into a control share statute so long as the board was otherwise complying with its fiduciary duties. In response, a number of closed-end funds have opted into such statutes or adopted control share provisions in their by-laws.

Mr. Colby described the nature of the claims in these litigations, which include breach of fiduciary duty, breach of contract, and rescission of the bylaws under Section 47(b) of the 1940 Act. Mr. Colby explained that "we are in the middle of this game" and have seen "mixed results." In the 2018 and 2019 time frame, certain advance notice and trustee qualification requirements were upheld. In 2020, however, an Arizona state court enjoined the application of a changed voting standard requiring 60% of the outstanding shares to elect directors in a contested election. Mr. Colby also described a case currently pending in Massachusetts where both a majority of outstanding shares voting standard and control share amendment are being challenged. Finally, Mr. Colby discussed a recent ruling from the Southern District of New York granting summary judgment in favor of the activist finding that the control share amendment at issue was in violation of Section 18(i) of the 1940 Act. Mr. Colby explained his strong disagreement with the decision and noted that it was being appealed to the Second Circuit Court of Appeals.

Other Litigation Developments. The panel noted a recent uptick in pre-litigation books and records requests, which can be made pursuant to applicable statute or the fund's governing documents. Mr. Colby noted how varied a shareholder's inspection rights can be depending on where and how the fund is incorporated. In Delaware, for example, shareholders have the right to inspect for any proper purpose a fair amount of records, including board emails in certain circumstances. In Massachusetts, on the other hand, shareholders have very limited inspection rights, unless the fund's governing documents grant broader access than the applicable statute. Upon receipt of such a demand, it is critical to focus on timing of response required and the scope of the materials that might need to be produced.

Compliance Challenges in the Current Environment: A Conversation with Fund CCOs

Moderator: **Tamara K. Salmon**, Associate General Counsel, Investment Company Institute

Speakers: **Peter Driscoll**, Partner, PricewaterhouseCoopers LLP

Brian Harris, Funds Chief Compliance Officer and Managing Director, State Street Global Advisors

Michael F. Hogan, Chief Compliance Officer, Charles Schwab Investment Management, Inc.

Christy Sears, Chief Compliance Officer, American Beacon Funds

The panel discussed how CCOs are addressing the existing regulatory environment. Ms. Salmon began by sharing statistics from a recent ICI study on the roles and responsibilities of CCOs. She stated that, of the 136 participating CCOs, 53% serve as CCO of both the funds and the adviser, and 69% have responsibilities other than serving as CCO (*e.g.*, legal, risk, audit, etc.). The panelists then introduced themselves and described their roles and the size and structure of the compliance groups in which they work. In addition to the compliance staff members that directly report to the CCOs on the panel, each CCO noted that he/she could utilize other resources within their organizations for support.

Ms. Salmon asked the panelists to comment on how they were handling the SEC's aggressive rulemaking agenda. The panelists discussed the difficulty in adding staff in this competitive job market and stated that the volume, depth and breadth of new and proposed rules had been particularly challenging. The panelists reported that in managing the new rules, they drew on different parts of their organizations and leveraged resources from the ICI and other entities. Mr. Driscoll stated that, in an effort to ease the burden, he helps his consulting clients identify key points in the rule proposals, provides advice on which components of the proposals likely will be part of the final rules and supports clients through technology improvements.

Ms. Salmon noted that, at a panel the prior day (The Fund Board Perspective on Regulatory and Industry Developments), registered fund directors stated that they wanted detailed information and documentation about the new rules, the costs of implementation and the funds' anticipated procedures for compliance. She asked how the panelists engage with their funds' boards with respect to new rules. Ms. Sears stated

that fund counsel provides a regulatory update to the board to highlight key components of a new rule, and she provides quarterly updates regarding progress toward the compliance dates. Messrs. Harris and Hogan said that they each had a similar process, with their business colleagues giving a presentation to the board as a rule's implementation date draws near. Mr. Driscoll stated that he finds it helpful to provide boards with the reasoning behind the rules, and noted that he prepares educational and training materials for his clients.

In responding to a question from Ms. Salmon regarding which responsibilities might be sidelined as CCOs focus on new regulatory requirements, the panelists stated that they took a risk-based approach and strove for efficiencies in managing heavy workloads. Mr. Harris stated that SSgA had formed a group to identify areas of emerging risk and leveraged other teams within the organization to carry out some of the more traditional compliance functions. Mr. Hogan said that he meets regularly with the corporate testing team to ensure that they are testing in the areas of most concern and identifying areas for continued improvement. Ms. Sears has focused on automating testing to the extent possible. Mr. Driscoll agreed that a risk-based approach was the right approach, and that it was increasingly critical to utilize technology to automate compliance functions where possible.

Ms. Salmon noted that the SEC's Division of Examinations and Division of Enforcement were taking a more aggressive tone toward funds and their advisers, with more aggressive timelines and negotiation postures, the forcing of express admissions of violations of law, increased use of subpoenas issued by the Division of Enforcement and more collaboration between regulators. Mr. Driscoll noted the SEC's focus on fund gatekeepers and stated that, while it used to be uncommon to see a CCO named in an enforcement action, it is becoming less so. The CCOs on the panel expressed that, while the more aggressive posture from the SEC does not impact their objectives, it does heighten concern regarding how minor issues might look in hindsight. Mr. Hogan stated that the SEC's focus on identifying a responsible party defies reality, as decisions are typically made by groups of individuals across the organization. Ms. Sears added that it is difficult for compliance personnel to do their jobs effectively if they feel there is a target on their back, as they need to be able to engage with management, provide advice and reach a consensus.

Ms. Salmon asked the panelists what they expected going forward from the Division of Examinations and whether the tradition of partnering with the industry would continue. Mr. Driscoll expressed his appreciation for the Risk Alerts issued by the Division, and stated that it would be helpful if the Division would publish copies of exam request lists so the industry could see what documentation was important to the examiners. Ms. Sears and Mr. Harris agreed that the Risk Alerts were helpful and that further educational materials would be appreciated. Mr. Hogan noted that the volume of data requests can be a challenge, and stated that it would be helpful if the Division clearly identified the objective of such requests.

To conclude the panel, Ms. Salmon noted that the ICI would continue to work with the industry to provide resources and support. She noted that the ICI had recently met with CCOs to discuss ESG initiatives and that she, Ms. Spears and others had developed a comprehensive due diligence document for use by sub-advised funds.

Good Cop, Bad Cop: Examinations and Enforcement Under the Gensler Commission

Moderator: **Matt Chambers**, General Counsel and Chief Compliance Officer, Horizon Investments, LLC

Speakers: **Vanessa L. Horton**, Associate Regional Director, Division of Examinations, Securities and Exchange Commission

Anthony S. Kelly, Partner, Dechert LLP

Dabney O'Riordan, Co-Chief, Asset Management Unit, Division of Enforcement, Securities and Exchange Commission

The panel discussed the environment and outlook for SEC examinations and enforcement proceedings under SEC Chair Gary Gensler.

Examination Priorities and the Role of the Division of Examinations. Ms. Horton was not at liberty to speak in detail about the 2022 exam priorities, as they had not been published in advance of the panel. However, she confirmed that this year's priorities would be consistent with past years' priorities, and would include both some perennial favorites (such as fees and expenses), as well as several topical areas of focus, including "the three C's"—Cyber, Crypto and Climate. She confirmed that the elevation of the

examination function within the SEC from an office to a Division of Examinations had positively impacted morale, had increased the Examination staff's involvement in rulemaking and had generally raised the Examination staff's profile within the SEC. She reported that the Division had conducted over 3,000 examinations in 2021 and was on track to conduct as many in 2022. Noting that the Division fields roughly 1,000 staffers, Ms. Horton characterized their goal as doing "a lot with a little."

Enforcement Environment. Regarding the enforcement environment under Chair Gensler, Ms. O'Riordan recited past public statements about developing the facts and applying the law in the public interest. She emphasized that Enforcement personnel focus attentively on the question of whether they are holding the right people accountable and requiring the right relief, each in light of the facts and circumstances of each enforcement case. Taking up the mantle of "bad cop" under the title of the panel, Mr. Kelly asserted that he was seeing a shift in the tone and approach of the Enforcement staff. He quoted from an October 2021 speech by Division Director Gurbir Grewal as embodying a new tone: "I'm from Jersey, and I know a thing or two about the Turnpike. . . . [One] thing I know is that if you post a 65 mile-per-hour speed limit and don't enforce it, people drive 75. . . . And they eventually do so with a sense of impunity. And then after a while they will drive 80 or faster, with a growing sense of confidence. As speeds climb higher and higher, you eventually have situations where accidents increase and heightened enforcement follows. But for all of the victims, it's too late." Building on this New Jersey Turnpike principle, Mr. Kelly predicted several changes, in particular (i) a significant number of technical cases, including violations solely of the compliance rules (Rule 38a-1 under the 1940 Act and Rule 206(4)-7 under the Advisers Act), (ii) continued "aggressive enforcement," such as imposing bars/disqualifications, (iii) increased monetary fines, (iv) focus on gatekeepers and (v) pressure to admit guilt in settlements. He also counseled that registrants should not expect multiple meetings with increasingly senior SEC staff, as the Division of Enforcement staff is decreasingly open to protracted discussions. His other observations were that (i) the time to make submissions in a case may be curtailed, (ii) the ability to negotiate language into a settlement agreement is increasingly limited and (iii) the waiver process for statutory disqualifications appears to be increasingly rigorous.

Level of Enforcement Penalties. Ms. O'Riordan discussed how the SEC staff approaches the determination of penalties in enforcement cases, noting that the SEC staff typically makes sure the pertinent facts are recited in the text of the settlement order itself. In determining penalties, she said the SEC staff considers (i) "specific deterrence," taking into account whether the defendant is a recidivist, (ii) "general deterrence" across the industry, (iii) harm to clients/investors (which is a factor, but not dispositive) and (iv) that the full Commission must affirmatively vote on any negotiated settlement.

Electronic Communications. Noting that remote working during the COVID-19 pandemic had placed additional pressure on compliance with respect to electronic communications, Ms. Horton stated that the topic of recordkeeping and electronic communications had been a focus of the Division of Examinations for a long time, and encouraged listeners to review in detail the SEC staff's risk alerts on the topic from August 2020 and from 2018. Mr. Kelly observed that firms are inherently limited in their ability to surveil independent actions by individual employees, and he laid out some best practices in the wake of the recent enforcement cases. He said that firms should (i) ask themselves "what more could we possibly have done to promote compliance?," (ii) have substantive policies that are not simply boilerplate, (iii) devote sufficient resources to be able to align practices with the written policies, (iv) follow up whenever there are red flags and address issues fully when they arise and (v) conduct extensive training to make sure employees understand their individual contributions to compliance by the firm.

Share Class Cases. The panel discussed recent enforcement actions over the selection of share classes by advisers to retail separately managed accounts (SMAs). Ms. O'Riordan observed that constant innovation in the industry results in shifting economics for advisers to retail SMAs, but that the basic principles of clear disclosure and mitigation of conflicts of interest persist throughout. She highlighted the conflicts that can arise when charging transaction fees to SMA client accounts, and encouraged care in the selection of share classes of cash sweep vehicles. Referencing the SEC's 2019 interpretive release on advisers' fiduciary duties, Mr. Kelly commented that, in contrast to the Rule 12b-1 cases from several years ago, which focused on disclosure and duty of loyalty, the current line of enforcement actions appears to place pressure on the evaluation and assessment of investment

options under the duty of care. Ms. O'Riordan retorted that the idea that an adviser can disclose away its duty of care is "anathema" to the public policy and case law surrounding fiduciary duty.

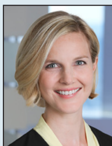
Cyber Matters. The panel turned to cybersecurity and discussed the August 2021 sanctions levied by the SEC against eight firms in three actions for failures in the firms' cybersecurity policies and procedures. The failures resulted in email account takeovers that exposed the personal information of customers and clients. Ms. O'Riordan commented that not every cyber breach results in enforcement. She asserted that firms susceptible to such an enforcement action include those that do not update their cyber program over time and those that are slow to react in the face of a cyber event, and she stressed that firms should make certain not to mislead clients about what has happened during the course of a cyber event. Ms. Horton noted that an adviser's preparedness for a cyber event should center around ensuring that the firm has (i) the right people, (ii) the right training, (iii) appropriate policies and procedures and (iv) a plan for responding promptly.

Reflections on Mutual Fund Examinations. The panelists discussed the October 2021 risk alert on observations from examinations in the registered investment company initiatives, noting that there was a lot of low-hanging fruit in deficiencies identified by the SEC staff. Ms. Horton commented that she is surprised by how often the Examination staff will see repeated failings in the 15(c) contract renewal process at the same firm in subsequent years, even after deficiencies have been identified by the SEC staff. She confirmed that the Examinations staff reviews a firm's responses in correspondence during its prior examinations, with particular focus on areas where the firm has represented how it has fixed or will fix a particular shortcoming. She also noted that the Examinations staff reads the complete board materials and will compare the documentation from one year to the next, in part in order to gain assurance that the process is dynamic and develops over time. In response to an audience question, Ms. Horton stated that the Examinations staff might speak directly with mutual fund board members, but this is "not terribly common." Mr. Kelly commented that, when he was working in the Asset Management Unit of the Division of Enforcement, the staff's perspective had been that the 15(c) process was an appropriate focus for SEC enforcement, but that the substantive question of excessive fees under Section 36(b)

of the 1940 Act was the province of private litigants rather than of the SEC.

Words of Wisdom. Each panelist was asked for a single takeaway for the audience. Ms. Horton emphasized the importance of carefully reviewing SEC staff risk alerts because the alerts are studied in detail by the Examinations staff when structuring exams. Ms. O'Riordan encouraged registrants to make their best arguments to the Enforcement staff as early as possible in the exam process, and also to focus only on key substantive concerns when marking up draft settlements. Mr. Kelly's advice was to encourage firms to spend the extra time and resources on crafting an exhaustive response to a deficiency letter or other correspondence coming out of an SEC examination, as subsequent reviewers (including from Enforcement) may rely heavily on those letters both for an understanding of the facts and for the best legal arguments supporting the registrant's positions.

LAWYERS WHO ATTENDED THE CONFERENCE OR CONTRIBUTED TO THE PREPARATION OF THIS SUMMARY



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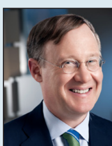

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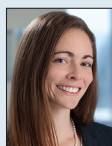

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