# 2014 MUTUAL FUNDS AND INVESTMENT MANAGEMENT CONFERENCE

ROPES & GRAY

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## President’s Address

*Speaker*: **Paul Schott Stevens**, President and CEO, Investment Company Institute

Mr. Stevens, in his opening address, outlined an argument for why registered investment companies and their advisers do not pose systemic risk to the financial system and should not be subject to bank-style prudential regulation.

Mr. Stevens explained that U.S. and international agencies were considering applying enhanced prudential regulation to the asset management industry, and that this has the potential to harm investment companies and their shareholders. In particular, he said, the Financial Stability Oversight Council (“FSOC”), created by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”), suggested that it might identify funds of $100 billion or more in size as non-bank systemically important financial institutions (“SIFIs”) subject to regulation by the Federal Reserve Board. Mr. Stevens said that fourteen funds, each a U.S. registered investment company, met this threshold.

Mr. Stevens explained that registered investment companies should not be identified as SIFIs or subjected to enhanced prudential regulation for the following reasons:

- Registered investment companies make little use of leverage, and are thus unlikely to contribute “fuel” to financial crises.
- Registered investment companies do not “fail” in the way that banks or insurance companies may. With daily pricing, it is difficult for a fund’s liabilities to exceed its assets. Many registered investment companies (and investment advisers) are wound up each year, with no disruption or need for governmental or taxpayer-funded assistance.
- Historical facts do not support the proposition that registered investment companies destabilize markets by crowding into particular asset classes and then selling those assets in a disruptive manner to fund large shareholder redemptions.
- The structure of registered investment companies (funds are legally separate from one another and from their investment advisers) and their substantive regulation (such as liquidity requirements, board oversight, and the simplicity of funds’ capital structures) limits systemic risk.

Mr. Stevens noted the vast potential implications of designating registered investment companies as SIFIs:

- The Federal Reserve Board may apply enhanced prudential regulation, potentially including the imposition of capital requirements, despite the fact that prudential regulation is intended to protect the banking system, not the discharge of fiduciary duties to fund shareholders.

- SIFIs may be taxed to support the FSOC and an orderly liquidation fund (i.e., a pool that will pay for future financial bailouts), increasing expense ratios and potentially resulting in mutual fund shareholders paying for the failures of the largest banks and insurance companies.
- SIFIs are required to hold greater levels of cash, which would affect the funds' pursuit of their investment objectives.

Mr. Stevens said that the ICI supported intelligent regulation, but would work to promote the existing framework for registered investment companies, in which regulators with industry and market expertise would address specific activities through a public rulemaking process.

## Keynote Address

*Speaker*: **Norm Champ**, Director, Division of Investment Management, U.S. Securities and Exchange Commission

Mr. Champ stated that the SEC's mission was to protect investors, to ensure fair and orderly markets, and to promote capital formation. He emphasized two themes: (i) the role of outside stakeholders and the Division of Investment Management in fostering continued innovation to meet the needs of public investors; and (ii) the monitoring and management of risk.

*Reorganization of the Division*. Mr. Champ reported that, in 2013, the Division of Investment Management (the "Division") examined its strengths and areas that could be improved. As a result of this review, the Division was reorganized into four groups: a disclosure group, the office of the Chief Counsel, a rulemaking office, and a business operations office. He said that the new structure allowed the Division to devote more resources to the study of exemptive applications, which he considers to be an important source of useful innovation.

The Division has created a Risk and Examinations Office ("REO"), which is staffed with a range of analysts, accountants, lawyers, and examiners. Mr. Champ said that REO is focusing on strategically important investment advisers, and that it has the ability to analyze large amounts of data. He attributed the recent Ambassador Capital Management enforcement action to REO's data analysis. REO represents an effort to identify and anticipate emerging risks, and it will play a role informing the rulemaking process and assisting the Division in allocating is resources.

*Rulemaking*. Mr. Champ said that the Division's approach to rulemaking would involve consideration of (i) the risk sought to be mitigated by the proposed rule initiative, keeping in mind the importance of protecting investors; (ii) the urgency of the initiative; (iii) the potential impact of the initiative on investors, shareholders, efficient markets, capital formation, and the operations of the Division and the SEC; and (iv) the availability of resources.

To inform rulemaking, the Division is considering ways to improve its information gathering. Mr. Champ said that the staff is developing a recommendation to modernize and streamline fund reporting on operations and portfolio holdings, and that this may involve substantial revisions to, and more frequent filings of, Form N-SAR.

Turning to current initiatives, Mr. Champ said that money market reform remained a rulemaking priority for the Division. In addition, he said that the Division was considering rules reforming variable annuity disclosure to improve communications about how these products are sold, potentially incorporating aspects of the mutual fund summary prospectus. Mr. Champ said that the staff was also considering rulemaking to address target date retirement fund marketing materials including, in response to recommendations of the Investor Advisory Committee (a body created by the Dodd-Frank Act to advise the SEC), a request for comment on standardized risk-based glide path illustrations. In addition, he said that the staff would continue to work on rulemaking related to exchange-traded funds ("ETFs") as well as remaining Dodd-Frank-required rulemaking, such as removing references to credit ratings from existing rules.

*IM Guidance*. Mr. Champ said that the Division would continue to issue regular staff Guidance Updates. He said that these Guidance Updates published staff views on discrete issues, and said that he did not consider them to be substitutes for rulemaking, exemptive application, or no-action letter processes.

*Monitoring*. The Division staff will continue to meet with senior management at funds and advisory firms and fund boards as part of an educational process intended to improve the staff's understanding of the industry. Mr. Champ said that the staff will focus on the migration of individual investors from brokerage to advisory accounts, an issue that had been noted through the staff's industry discussions. He said this issue was also a priority for OCIE in 2014, and that dual registrants should consider whether a recommendation to move a client from a brokerage account to an advisory account is consistent with fiduciary obligations and the client's best interests. Mr. Champ said that the staff's monitoring efforts had also led it to focus on cybersecurity and to join with OCIE examiners in an ongoing initiative to review distribution fees and practices.

In closing, Mr. Champ said that he was always interested in hearing new ideas from the industry, but that he wanted to see that proposals conferred clear benefits for investors.

## General Session — The Benefits of Hindsight: A Discussion with Former SEC Commissioners and Division Directors

*Moderator:* **Natalie Bej**, Principal, Securities Regulation, Legal Department, Vanguard

*Speakers*: **Barry P. Barbash**, Partner, Willkie Farr & Gallagher LLP
**Andrew J. Donohue**, Managing Director and Deputy General Counsel, Goldman, Sachs & Co.

**Troy Paredes**, Former Commissioner, U.S. Securities and Exchange Commission Steven M. H. Wallman, Chief Executive Officer, FOLIOfn, Inc.

The panelists in this session provided their views on recent regulatory developments, including the Dodd-Frank Act, money market reform, the designation of SIFIs, and the rulemaking process.

*The Dodd-Frank Act and Money Market Reform.* The panelists began by commenting on the current regulatory environment. Focusing on the Dodd-Frank Act, Mr. Paredes stated that its cumulative effect is “too much regulation.” He noted that while problems needed to be addressed in the wake of the 2008–2009 financial crisis, the Dodd-Frank Act is excessive in that it imposes substantially higher costs of doing business and significant barriers to entry, which will hurt investors in the long run. Turning to money market funds, Mr. Paredes stated that FSOC is not the appropriate regulator for these vehicles, given its structure and grounding in the bank regulatory environment. Mr. Donohue noted that money market funds were not the cause of the financial crisis, and that imposing excessive regulatory burdens on them will ultimately impair the overall economy. He stated that FSOC does not have the regulatory experience to oversee these vehicles, and that only the Securities and Exchange Commission (“SEC”) can occupy this role. Mr. Barbash agreed and urged the SEC to aggressively take the lead on dealing with money market fund reform.

*Systemic Risk and SIFIs.* Mr. Barbash addressed the topic of the potential designation of advisors and funds as SIFIs. He stated that while the recent report from the Office of Financial Research raised good questions about systemic risk in the asset management industry, multiple regulators dealing with this issue will only create confusion and bad results. Mr. Wallman opined that international regulators are further complicating the situation. While acknowledging that getting differing points of view on systemic issues is useful, Mr. Wallman stated that each regulator brings its own parochial perspective to the topic, and that any attempt to "harmonize" various regulatory initiatives could lead to bad results.

Mr. Barbash stated that regulatory agencies should engage in self reflection and introspection. Mr. Paredes noted that addressing one type of risk can lead to new risks and distortions being created. He cautioned that regulators should not look at risk too narrowly. Mr. Wallman noted that markets are designed to allocate certain types of risk, and that it would be foolish to attempt to eliminate all risk. He noted that regulators should not be substituting their business judgments for that of the marketplace.

*The Need for Bottom-Up Rulemaking.* Mr. Barbash then addressed the role of economic analysis in SEC rulemaking, asking why the SEC seems to be losing so many cases. He observed that the core of the issue is not faulty economic analysis, but rather the SEC developing rules from the “top down” rather than from the “bottom up.” The panelists noted that the best regulations from the SEC emanate from the staff, and not from the Commissioners themselves. Mr. Wallman noted that the legal environment for challenging rules has also changed. He stated that judges are more skeptical of the

SEC's initiatives, and that industry participants are much more willing now to challenge rules.

Mr. Paredes raised concerns about the impact of more regulations on innovation and competitiveness. He suggested that regulators tread lightly with proposed new regulations, and that they should not adopt a "one-size-fits-all" mentality.

## General Session — Regulatory Developments at the SEC: Is This the New Normal?

*Moderator*: **Dorothy M. Donohue**, Acting General Counsel, Investment Company Institute

*Speakers*: **Diane C. Blizzard**, Associate Director, Rulemaking, Division of Investment Management, U.S. Securities and Exchange Commission
**Rajib Chanda**, Partner, Ropes & Gray LLP
**Amy R. Doberman**, General Counsel, ProShares Advisors LLC
**John M. Zerr**, General Counsel, Invesco Advisers, Inc.

This panel discussed regulatory developments and rulemaking initiatives at the SEC, including initiatives relating to ETFs, target date funds, portfolio holdings disclosure, money market funds, private fund advertising, and "say on pay" rules.

Ms. Blizzard stated that the SEC was focused on both discretionary rulemaking and rulemaking that was mandated by the Dodd-Frank Act. She said that the SEC is required to publish its regulatory agenda each April and October, and generally includes in this "Reg Flex" agenda only items that it believes the staff will be able to turn to within the next year. She explained that derivatives guidance was not on the current regulatory agenda because, while the staff is working on it, the SEC does not expect to be able to issue derivatives guidance in the next year.

*ETFs*. Ms. Doberman noted that while the 2008 ETF rule proposal would have permitted active and passive ETFs with full transparency and with only limited restrictions on investments, current exemptive applications for ETFs were subject to more restrictions than were contemplated by the proposed rule. Ms. Blizzard said that ETF rulemaking was a Division priority, but that a new version of the rule would be proposed. She explained that the products had changed over the last few years and that the staff would consider (i) whether the active versus index distinction was relevant; (ii) how much transparency should be required; (iii) what flexibility was appropriate for creation/redemption baskets; and (iv) how to address the use of leverage and derivatives. She said that the Division currently had authority to provide two separate types of ETF relief under delegated authority from the SEC -- relief for active ETFs and relief for index ETFs -- and that applicants' products needed to fit within either the "active" or "index" bucket.

*Glide Paths*. Ms. Blizzard stated that, in 2008, funds near their target dates lost between 9% and 43% of their assets. She said that this prompted the 2010 rule proposal on glide paths, addressing the concern that investors may not have understood that target date funds with the same target dates could perform so differently. She said that the Division hired a contractor to survey investors and that the contractor's 2012 report to the Division indicated that many investors had misconceptions about target date funds. The Division was now, in response to this information and a recommendation by the Investor Advisory Committee, working to develop a glide path illustration based on a measure of risk (potentially a measure of exposure to loss or volatility). She said that a glide path illustration based on asset allocation did not appear to portray portfolio risk adequately.

The other panelists questioned whether a risk metric would be helpful, whether investors would understand it, whether it might drive investors towards inappropriately conservative target date funds, whether it was necessary for plan sponsors who chose particular target date funds to offer this information to plan participants, and whether it made sense to require a risk metric only for target date funds.

*Portfolio Holdings Disclosure*. Ms. Blizzard said that portfolio holdings disclosure was an important initiative of the Division and that the staff was working on a new form applicable to all mutual funds inspired by the success of Form N-MFP for money market funds. She said that substantial updates to Form N-SAR were also under consideration. Ms. Blizzard said that the staff's goal for this initiative was to facilitate the identification of industry trends through the collection of high value information in a format that would be easy to work with and aggregate. She said that the staff was sensitive to industry's desire to protect the confidentiality of portfolio holdings. Other panelists raised concerns regarding, in addition to confidentiality, the potential costs of providing information to the SEC.

*Money Market Funds*. Mr. Chanda reviewed the recent history of money market funds, commenting on the Reserve Fund's "breaking the buck" in 2008, the Federal Reserve Board's money market fund insurance program, and the 2010 rule changes focusing on limiting portfolio risk through the imposition of liquidity and other requirements. He reviewed the 2013 money market fund proposal, which included two alternatives that could be adopted alone or in combination: (i) a requirement that prime institutional money market funds transact at a floating net asset value, and (ii) permitting money market funds to transact at $1.00 per share but allowing them to use liquidity fees and redemption gates when necessary. Mr. Chanda then reviewed current European approaches to money market funds, including proposed regulation. He said that this remained an area of high regulatory activity in the U.S. and Europe, but that market participants were currently in a "wait and see" mode.

*Private Fund Advertising*. Ms. Blizzard said that the Division of Corporate Finance was leading an initiative to review private fund advertising practices with the involvement of the Division of Investment Management. She said that there had not been a significant amount of public advertising in connection with private funds' private placements for several reasons, including that non-U.S. jurisdictions generally continue to prohibit general solicitation in connection with private placements and that CFTC exemptions often used by private funds did not allow public advertising.

Ms. Blizzard said that the current Form D did not provide enough information for the SEC to learn much about general solicitation activities of private funds. She said that amendments to Form D were under consideration to require: (i) a closing amendment to Form D reporting on the results of the offering; (ii) more information about the issuer and its solicitation; (iii) additional disclosure and legend requirements; and (iv) reporting regarding disqualification provisions in Rule 506. She said that the staff was also considering extending Rule 156 under the Securities Act of 1933 to private funds.

*Say on Pay*. Ms. Blizzard said that the staff was still working on a rule requiring quantitative reporting on say on pay votes. Mr. Zerr said that the issuer community was very focused on say on pay votes, even though the votes were only advisory in nature. He said that issuers are focused on the role of proxy advisory firms, and that, at a December 2013 SEC roundtable on proxy voting, proxy advisory firms were criticized for a lack of transparency, basing recommendations on inaccurate data, having too much influence on votes, and having conflicts of interest. He said that institutional investors were also criticized for effectively outsourcing their fiduciary duties to vote by relying on proxy advisory firm recommendations, and that the SEC was criticized for facilitating the situation through no-action guidance issued to the proxy advisory firms. He observed that institutional investors typically did not simply rely on proxy advisory firms, but instead considered those firms' recommendations in reaching their own conclusions. Ms. Doberman observed that the importance of proxy voting varies with a fund's investment strategy, so that a "one size fits all" approach to proxy voting did not necessarily make sense.

*IM Guidance*. Ms. Blizzard said that the IM Guidance Updates were intended as suggestions for industry to consider. The panelists, using the recent guidance regarding fixed income funds as an example, said that, in practice, there was a real risk that the guidance would be interpreted by the staff of the Division, OCIE, and the industry as having the authority of a rule, even though IM Guidance Updates are not subject to the notice and comment safeguards of the Administrative Procedures Act.

## Session 1-A — Current Tax Developments

*Moderator*: **Karen Lau Gibian**, Associate Counsel, Tax Law, Investment Company Institute

*Speakers*: **Stephen D. Fisher**, Principal, Financial Services–Tax, Ernst & Young, LLP
**Robert J. Foley**, Director, Product Tax Department, State Street Bank and Trust Company
**David J. Mangefrida Jr.**, Senior Vice President and Director of Tax, Calamos Investments

This panel focused on the current developments in tax regulation that may have an impact on funds.

*Section 871(m): Withholding on Dividend-Equivalent Payments*. Mr. Fisher spoke about proposed regulations under Internal Revenue Code Section 871(m), which Congress enacted in 2010 to combat the use of swaps to avoid withholding on dividends paid with respect to U.S. equities to non-U.S. persons. Such dividend-sourcing tax arbitrage was made possible by the different sourcing rules applicable to the taxation of dividend income (based on the residence of the issuer of the dividend-paying stock) and swap income (based on the residence of the taxpayer). Regulated investment companies (“RICs”) are most likely to run into these rules when they have short equity exposure, and are thus making dividend-equivalent payments on dividend-paying stocks, whether through a swap position, a short sale, or otherwise.

The proposed regulations address payments on (i) specified notional principal contracts (“specified NPCs”) contingent on, or determined with reference to, payment of U.S.-source dividends; and (ii) a broader category of so-called equity linked instruments (“ELIs”). The effective date of the ELI rules has been delayed so as to apply only to positions acquired at least 90 days after the adoption of the final regulations. ELIs are defined broadly to include options, forwards, and futures contracts with a delta (the difference between the performance of an instrument and the performance of the underlying asset(s) to which the instrument refers) greater than or equal to 0.70. Whether a particular position constitutes an ELI is determined (i) at the time the position is acquired -- if it is an ELI at that time, it will remain an ELI notwithstanding any drop in the correlation between the performance of the instrument and the underlying reference asset; and (ii) at the record date for payment in order to determine the applicable withholding obligation.

*International Tax: Foreign Tax Reclaims.* Mr. Mangefrida spoke about the prospects for obtaining refunds (so-called “reclaims”) of foreign tax -- whether “Santander” European Union (“EU”) reclaims under former Article 56 (now Article 63), or non-EU reclaims -- in a series of different countries. He reported that the ICI has made significant progress by taking the question of foreign tax reclaims to “competent authority” in the U.S. (i.e., various IRS and Treasury representatives who negotiate tax issues on behalf of common interests of U.S. taxpayers). Mr. Mangefrida generalized that a number of countries are trying to postpone or even eliminate any requirement that they pay reclaims by (i) rejecting claims and asking serial questions, apparently in the hope that the taxpayer will miss a deadline (Austria); (ii) requiring proof of signature authority (Italy); (iii) treating RICs as fiscally transparent and thus denying that the RIC can make a claim in its own right (Norway); (iv) imposing onerous demands for shareholder information (Netherlands, South Korea); (v) trying to establish that the funds are not sufficiently similar to the funds that were the subject of the taxpayer-favorable decision in the Santander case; or (vi) so complicating the process as to make most reclaims uneconomical (Philippines).

*Foreign Account Tax Compliance Act ("FATCA")*. Mr. Foley discussed FATCA, which imposes new documentation, reporting, withholding, and/or account diligence requirements, to varying degrees, on foreign financial institutions ("FFIs"), non-financial foreign entities, and U.S. withholding agents, and the final FATCA regulations that were published in January 2013. Mr. Foley indicated that the first "soft deadline" for registering for the FATCA program is April 25, 2014. He observed that, after having originally been skeptical and unenthusiastic about FATCA's enactment in 2010, a number of European governments are now happy to have a means, through the bilateral exchange of information, by which they can determine the countries in which their nationals have invested in foreign accounts. Forty-one countries have entered into inter-governmental agreements for the exchange of information and there is a likelihood that other countries will enter into automatic exchange of information agreements. Mr. Foley noted that compliance issues could arise from the overlapping, but not completely identical, information reporting obligations that these regimes impose.

*U.S. Tax Developments.* Ms. Gibian discussed current U.S. tax developments. She noted that the prospects for the so-called "extenders" legislation are unclear at this time, and then addressed the discussion draft for the Tax Reform Act of 2014 introduced in February by Ways & Means Committee Chair Dave Camp (the "Camp Tax Reform Discussion Draft"). The Camp Tax Reform Discussion Draft provisions principally implicating registered funds include (i) proposals relating to derivatives on publicly-traded securities, which are proposed to be required to be marked to the market as ordinary income or loss; and (ii) a fundamental change in the treatment of net capital gains, which are proposed to be no longer eligible for an explicit reduced rate, but 40% of which will be deductible in the computation of net capital gains subject to tax.

The Camp Tax Reform Discussion Draft would reduce the number of income tax brackets from seven to three: 10%, 25%, and a 10% surtax raising the top marginal rate to 35%. It proposes to repeal the alternative minimum tax, but at the same time, to add back certain exclusions (such as municipal bond interest) and deductions for the purposes of determining amounts subject to the 10% surtax. While it proposes to require all taxpayers to account for sales of securities on a first in, first out ("FIFO") basis, the Joint Committee Technical Explanation of the Tax Reform Discussion Draft suggests that average-cost basis will remain available in respect of RIC shares. It would impose an excise tax on the excess total consolidated assets of SIFIs (i.e., entities with assets having a value exceeding $500 billion).

Mr. Fisher noted a somewhat surprising implication of the Camp Tax Reform Discussion Draft that would modify the definition of passive income used for determining whether an entity can fit within the category of publicly traded partnerships eligible for partnership treatment by limiting the permissible categories of passive income to income from activities relating to mining and natural resources. If not amended, an unanticipated effect of excluding investment income as a category of passive income would be to cause tender option bond structures currently used to convert long-term bonds to Rule 2a-7-eligible investments to be treated as corporations rather than as largely transparent vehicles.

Ms. Gibian indicated that another proposal in the Camp Tax Reform Discussion Draft would be to require capital contributions by non-shareholders to be currently included in income. Mr. Mangefrida observed that this would arguably have the effect of defeating the purpose of such contributions to restore or to supplement net asset value.

Ms. Gibian further indicated that the Camp Tax Reform Discussion Draft will require accrual-basis taxpayers to include items of income no later in the year in which the item is included for GAAP purposes, thus requiring a greater familiarity with when items are included for GAAP purposes. It would also modify the corporate return due dates, first to apply on the 15th day of the fourth (rather than third) month following the table year end, and provide for automatic six-month extensions.

Finally, Ms. Gibian indicated that the Camp Tax Reform Discussion Draft includes three meaningful retirement-related changes, the net effect of which is to push individuals into Roth Individual Retirement Accounts ("IRAs"). First, it would eliminate the income-eligibility limits for contributions to Roth IRAs and prohibit both new contributions to traditional IRAs and nondeductible contributions to traditional IRAs. Finally, it would encourage taxpayers subject to the 10% surtax to participate in Roth 401(k) plans relative to traditional 401(k) plans, withdrawals from which are subject to a 35% tax rate.

## Session 1-B — Are We There Yet? Rules of the Road for Fund CPOs

*Moderator*: **Rachel H. Graham**, Senior Associate Counsel, Securities Regulation, Investment Company Institute

*Speakers*: **Ruth S. Epstein**, Partner, Stradley Ronon Stevens & Young, LLP
**Erik D. Ojala**, Senior Vice President, Associate General Counsel, and Secretary, Harbor Capital Advisors, Inc.
**Tara W. Tilbury**, Vice President and Group Counsel, Ameriprise Financial,Inc.
**Jennifer Sunu**, Director of Audits, National Futures Association

This panel discussed issues facing fund commodity pool operators ("CPOs") under the recently amended CFTC rules, including Rule 4.5 testing, NFA examinations, harmonization, and Form CPO-PQR. Ms. Graham commenced the discussion by noting that, in the next couple of months, the ICI plans to form a new committee to address issues that are unique to advisers that are required to register as CPOs.

*Rule 4.5 Testing.* Ms. Tilbury explained that there are benefits to daily portfolio testing of registered funds that satisfy the trading and marketing eligibility requirements under amended Rule 4.5 ("4.5 Funds"). She pointed out that daily testing of 4.5 Funds can help to avoid a last minute need to register as a CPO and will allow funds to monitor trends in their use of commodity interests, which could be useful for gauging the potential impact of increased margin requirements in connection with the shift to cleared swaps. She noted that, for funds with multiple advisers, a decision is needed about whether each adviser is responsible for staying under the trading thresholds with respect to its sleeve of the fund, or whether the fund's overall status against the thresholds is shared with the advisers so that they can take advantage of any headspace available against the fund-level limits.

Ms. Epstein emphasized the importance of advance planning if a 4.5 Fund is in danger of exceeding the thresholds in the rule, particularly where (i) the adviser is not already a registered CPO, and therefore would need to register before the 4.5 exemption is withdrawn: or (ii) the fund has one or more sub-advisers that are not registered commodity trading advisors ("CTAs") because they are relying on the fund's status as a 4.5 Fund.

*NFA Examinations.* Ms. Sunu noted that, in light of recent rule changes, the number of CPO members of the National Futures Association ("NFA") has jumped from approximately 1,200 to 1,800 and the number of commodity pools overseen by the NFA has increased from approximately 1,800 to over 6,000. She stated that the NFA typically examines approximately 400-600 firms a year and has a goal of examining all firms every 3 to 5 years. She explained that there is no set schedule for member examinations; examination determinations are made using a risk management system that takes into account information from a number of sources, such as customer complaints, financial filings, background information, and disclosure documents. Some firms are examined every year as a result of the risk management system and others every few years. She indicated that the NFA almost always, particularly for CPOs, provides advance notice of onsite exams, typically 2 to 4 weeks in advance, along with a list of records the NFA would like to review on its first day of field work. She said that, to date, the NFA has completed approximately half a dozen exams of new fund CPOs, focusing on larger CPOs. She noted that for an NFA examination, four auditors may be engaged onsite for one to two weeks for smaller CPOs and up to seven auditors may be engaged onsite for three to four weeks for larger CPOs. She also said that the NFA tries to coordinate with the SEC so that a firm is not being examined by both the SEC and NFA at the same time. She indicated that NFA exams of fund CPOs tend to focus on the valuation of pool assets, do not focus on SEC requirements, and do not touch upon 4.13(a)(3) exempt pools unless there are red flags that warrant further review of the exempt pools.

*Harmonization.* Ms. Epstein discussed rule harmonization between the CFTC and SEC. She explained that one of the conditions to taking advantage of substituted compliance is that a fund's prospectus disclosure must comply with SEC disclosure requirements as well as a limited number of additional CFTC requirements. She noted that the CFTC provided no guidance on how related account performance should be displayed in the prospectus when it is required under the harmonization rules, creating interpretive questions for funds to address in deciding how to calculate and display related account performance for funds with less than 3 years of operations.

Ms. Sunu reported that a CPO can ask for an extension for an annual report filing, but it will only be granted if the extension request is received prior to the deadline for filing the annual report (90 calendar days after the pool's fiscal year end), preferably with enough time for the request to be processed before the deadline. She said that extensions are generally available for funds-of-funds and other extensions are available on a case-by-case basis, typically when additional time is needed to complete valuations. She noted that requests for extensions that exceed 90 days from the original due date generally will not be granted. Ms. Sunu indicated that if financial statements cover both CPO funds and 4.5 Funds, the combined statements should be filed and the NFA will focus on the CPO Funds.

Ms. Epstein described the non-harmonized aspects of recordkeeping. She noted, for example, that all records required under CFTC Rule 4.23 must be maintained in accordance with CFTC Rule 1.31, which has several unusual, outdated provisions for electronic records. The panel noted that the ICI has recently submitted a petition for further rulemaking to obtain clarity on which records are maintained under the SEC's rules and which are covered under the CFTC's rules and to request further harmonization on recordkeeping and temporary no action relief on an expedited basis.

*Form CPO-PQR.* Because there is little guidance on completing Form CPO-PQR, Ms. Tilbury noted that CPOs could benefit from rigorously documenting assumptions made about the information being sought by the form's questions and why and how questions were answered as they were, in order to better respond to potential questions from the CFTC or NFA. Mr. Ojala said that the CFTC has made clear that a controlled foreign corporation ("CFC") needs to be treated as a separate entity from its parent fund, meaning that the CPO of a CFC must register unless an exemption is available with respect to the CFC. He also noted that the harmonization rules do not apply to CFCs because a CFC is not a registered investment company, but that in the harmonization rule release it was noted that a CFC is not required to provide a separate disclosure document if the fund's prospectus provides disclosure regarding the CFC, including the principal risks associated with the CFC's investments. He described available non-self executing relief from the requirement to provide an annual report to pool participants in CFCs and the non-self executing relief allowing consolidated Form CPO-PQR filings covering funds and CFCs.

*Additional Requirements.* Ms. Sunu described NFA-specific requirements that apply to Fund CPOs once they register. CPOs must have a written ethics training procedures and disaster recovery plans. Ms. Sunu further noted that the NFA requires all members to conduct an annual self-examination using the checklist found on the NFA's website, which the NFA typically requests to review during the examination process. In addition, she explained there is a separate annual questionnaire that members are required to complete and submit to the NFA, which is used as part of NFA's risk management system.

Ms. Sunu said that the NFA's concept release about having a minimum capital requirement for CPOs is not a proposed rule and that the NFA is open to hearing from the industry about whether it is appropriate. She said that the comment deadline is April 15. Ms. Graham noted that the ICI is in the process of completing its comment letter on the concept.

### Session 1-C — Trading Compliance and Best Execution: What Every Lawyer Should Know

*Moderator*: **Ari Burstein**, Senior Counsel, Capital Markets, Investment Company Institute

*Speakers*: **Lisa I. Bloomberg**, Senior Vice President and Deputy General Counsel, OppenheimerFunds, Inc.
**Ralph Mittl**, Principal, Ernst & Young LLP
**Eric M. Pollackov**, Managing Director, Charles Schwab Investment Management, Inc.
**Steven W. Stone**, Partner, Morgan, Lewis & Bockius LLP

This panel discussed practices and developments with respect to trading, with a particular emphasis on best execution and soft dollars.

*Best Execution.* Mr. Stone explained that although there is no statutory or rule-based definition of "best execution," it is frequently described as the duty of an investment adviser to seek to execute securities transactions so that the total cost of a purchase or total proceeds of a sale are the best reasonably available under the circumstances. He noted that despite the increased transparency into equity trading costs afforded by tools such as transaction cost analysis ("TCA"), evaluation of best execution still depends significantly on the circumstances of each trade, including the nature of the security, the size of the trade relative to average daily trading volume, and how the trade relates to the portfolio manager's strategy. Ms. Bloomberg stressed the importance of monitoring trading data for potential trends, and reported that her firm shares TCA data with its mutual fund directors.

*Trading Review.* Ms. Bloomberg noted the importance of involving multiple groups in the review of trading, including information technology, portfolio management, trading, compliance, and legal. Mr. Pollackov reported that his firm involved traders and portfolio managers in the drafting of desktop procedures relating to trading and reporting. He noted that changes to strategies may require revisions to trading policies and procedures, and Ms. Bloomberg emphasized the importance of ensuring that trading practices remain consistent with advisers' and funds' disclosures.

Mr. Stone noted that, having developed the National Exam Analytics Tool ("NEAT"), the SEC staff now routinely requests multiple years of trading data and is undeterred by the size of data files provided. As a result, investment advisers will want to analyze the same data, and will want to document their review of any transactions that are flagged in their review of that data.

*Soft Dollars.* Mr. Burstein noted that the Financial Conduct Authority ("FCA") consultation on dealing commissions would prohibit firms operating in the UK from using soft dollars to pay for access to corporate management of issuers in which the firms may invest (unlike the U.S., where the SEC's 2006 soft dollar guidance permits the use of soft dollars for access). As a result, investment advisers with closely integrated trading systems could potentially find themselves unable, as a practical matter, to use soft dollars for corporate access in any jurisdiction. Mr. Burstein noted that this would appear to be an area in which the International Organization of Securities Commissions ("IOSCO") could help develop global standards.

*Electronic Trading.* The panel discussed the challenges and opportunities presented by increased electronic trading. Mr. Burstein reviewed data showing significant increases in electronic trading in recent years, noting that both average commission costs and average order size had decreased over time. Mr. Burstein commented that asset managers in Hong Kong using third-party trading algorithms are now required to perform due diligence on sell-side providers of electronic trading systems. Ms. Bloomberg stated that her firm involves its technology group, as well as portfolio managers and traders, whenever the use of a new platform is proposed. Mr. Burstein noted that the ICI is developing a standard questionnaire for intermediaries selling mutual fund shares that could promote efficiency.

*Examinations and Proceedings.* Mr. Stone reviewed several recent enforcement proceedings against small investment advisers using an affiliated broker and the SEC's recent cross-trading case against Western Asset Management. Mr. Stone observed that in recent examinations, the SEC staff has asked for documentation explaining differences between pre-trade and post-trade allocations of aggregated trades.

The panel discussed best execution in fixed income and derivatives markets, noting that although there is less trade data available for fixed income than for equities, the TRACE system provides some information on corporate fixed income securities. The panelists agreed that having processes in place for seeking multiple bids and comparing trading results to recent and subsequent trades (to the extent such trade information is available) appears to be of importance to the SEC staff.

## Session 1-D — Valuation Trends: Squaring Industry Practices with Regulatory Expectations

*Moderator*: **Robert C. Grohowski**, Senior Counsel, Securities Regulation, Investment Company Institute

*Speakers*: **Elizabeth Duggan**, Managing Director, Global Evaluated Services, Interactive Data Corporation
**Paul Kraft**, Partner, Deloitte & Touche LLP
**Philip H. Newman**, Partner, Goodwin Procter LLP

**Douglas J. Scheidt**, Associate Director and Chief Counsel, Division of Investment Management, U.S. Securities and Exchange Commission

The panel discussed regulatory expectations of the SEC and its staff regarding fund portfolio valuation and evolving market practices and trends in the industry in the areas of (i) valuation policies and procedures; (ii) board oversight and delegation; (iii) pricing vendor due diligence; (iv) backup pricing sources, price challenges, and price overrides; and (v) back testing and stress testing.

*Potential SEC Guidance.* Mr. Grohowski asked Mr. Scheidt to comment on the timing of possible guidance from the SEC on fund valuation matters, as has been cited as an initiative by representatives of the SEC and the Division in prior forums and speeches. Mr. Scheidt said that this is not likely to be a near term project of the SEC in light of other priorities, but that the Division may provide guidance on discrete topics relating to valuation. He did not specify which areas might be covered in any Division guidance and noted that “nothing is set in stone” and “nothing will happen any time soon.”

*OCIE’s Findings.* Mr. Scheidt summarized various recent findings of the Division of Investment Management’s Office of Compliance, Inspections, and Examinations (“OCIE”) relating to fund valuation, noting OCIE’s focus on inadequate valuation policies, failure to consistently follow valuation policies, inadequate disclosure of changes to policies that have a material impact on valuations, failure to update valuations in response to relevant events, and withholding of pricing issues and errors from the compliance department, valuation committee, or fund board. He also discussed valuation themes in recent SEC enforcement cases, including the valuation of illiquid assets, use of stale prices, failure to consider available dealer quotes and other market information that would negatively affect valuations, lax valuation committee oversight, undue influence of portfolio managers, and reliance on the premise that all trades are “distressed” without a sound factual basis for that conclusion.

*Morgan Keegan Case.* Mr. Newman commented that statements in the SEC’s June 2013 settlement order with former directors of the Morgan Keegan funds and the related expert testimony of former SEC Chairman Harvey Pitt have created significant uncertainty among fund directors regarding their roles and responsibilities with respect to fair valuation and whether regulatory expectations have changed. Mr. Scheidt said that in his view the Morgan Keegan settlement does not reflect a change in regulatory requirements or expectations. He said that the settlement order sets forth the facts of what the Morgan Keegan directors did and did not do in that particular case to serve as the basis for the SEC’s findings, but that this should not be considered SEC or Division guidance as to what other fund boards must do to satisfy their responsibilities in other circumstances.

Mr. Kraft noted that Deloitte & Touche’s 2013 Fair Value Pricing Survey suggests that fund boards have been keenly focused on the Morgan Keegan settlement order and that many have taken action in response to the findings involving the Morgan

Keegan directors, with 78% of the survey participants having changed their valuation policies and procedures over the last year, 54% having changed the types of valuation materials provided to the board, and 57% having changed the level of detail in the valuation materials.

The panelists discussed the SEC's criticism in the Morgan Keegan order that the valuation policies and procedures adopted by the board did not require the directors to ratify any fair valuations determined by the adviser. Mr. Newman questioned the appropriateness and effectiveness of calling on boards to ratify fair valuations after they have been calculated by the adviser and factored into daily net asset values. He pointed out that such ratification may take place weeks or months after the fact if the board considers the matter at its next regular meeting. Mr. Scheidt indicated that he does not see a need for the board to ratify fair valuations calculated by the adviser pursuant to an adequate board-approved methodology, but suggested that some form of board ratification or affirmation is necessary where the adviser determines fair values with no approved methodology or board involvement, so as to satisfy the board's obligation to "determine" fair values in good faith under Section 2(a)(41) of the Investment Company Act of 1940 (the "1940 Act").

*Pricing Vendors.* The panelists discussed the use of pricing vendors and related due diligence efforts. Ms. Duggan noted an increase in fund boards that meet with and receive presentations from Interactive Data Corporation ("IDC") and other vendors, but indicated that the presentations typically do not involve a "deep dive" into security-specific valuations and methodologies. She noted that IDC has in some cases provided on-site diligence sessions attended by fund directors and management. Regarding the use of secondary pricing vendors, Mr. Scheidt stressed that advisers and boards should have a "backup plan" in the event that a fair valuation methodology no longer works under the circumstances and should regularly test the accuracy of fair value prices by comparing them with values that are available from other sources.

A member of the audience raised the question of whether prices of debt and other securities that are determined by pricing vendors using evaluated or "matrix" pricing should be considered fair values or market values under Section 2(a)(41) of the 1940 Act. Mr. Scheidt expressed the view that evaluated/matrix prices are not market quotations and that, when used, the fund board should be familiar with and understand the methodologies used by the pricing vendor to calculate the prices and should review and monitor the effectiveness of the prices. Mr. Goodwin noted that there are differing views in the industry and pointed out the practical difficulties boards face in overseeing this area, particularly for bond funds that value substantially all of their portfolios using evaluated/matrix prices provided by vendors.

## Session 2-A — Current Topics for Fund Boards: Independent Counsel Roundtable

*Moderator*: **Amy B. R. Lancellotta**, Managing Director, Independent Directors Council

*Speakers*: **John E. Baumgardner Jr.**, Partner, Sullivan & Cromwell LLP
**Paulita Pike**, Partner, K&L Gates LLP
**Domenick Pugliese**, Partner, Paul Hastings LLP

This panel discussed current issues affecting fund boards, including the SEC's recent focus on board oversight, challenges related to oversight of payments to intermediaries, alternative funds, and investment performance, and fund governance issues.

*SEC's Recent Focus on Board Oversight.* Ms. Lancellotta remarked that 2013 was a big year for fund directors, citing the following developments: (i) two separate SEC enforcement proceedings in which fund directors (including independent directors) were sanctioned (Morgan Keegan and Northern Lights); (ii) SEC Chair Mary Jo White's October 2013 speech, in which she emphasized the "gatekeeper" role that independent fund directors play and stated that the SEC intended to scrutinize fund directors' conduct; and (iii) SEC Division of Investment Management Director Norm Champ's March 2013 speech, in which he called attention to a number of the types of difficult decisions that fund directors are called upon to make.

Ms. Pike expressed the view that close SEC attention to the activities of fund boards is "the new normal" and is likely to persist. She said, however, that fund boards, in her experience, have long taken their responsibilities seriously and acted conscientiously, and that boardroom behavior has consequently not changed significantly as a result of the heightened SEC scrutiny. Mr. Pugliese agreed, but noted that boards, in his experience, are now focusing more intensely on the specific topics that have received close SEC attention, such as valuation.

The panel discussed the SEC's recent practice of seeking to interview fund independent directors as part of the ongoing "sweep" examination of securities lending practices. Mr. Baumgardner noted that, although it is a new practice for SEC examiners to seek to interview outside directors, the practice is well-established in the bank regulatory arena. It is natural, he said, that regulators would want to talk with the "watchdogs" in any regulated industry. Mr. Pugliese noted that it would be awkward to decline a request by the SEC staff for an interview. He also said that any director who participates in such an interview should prepare carefully for it and should be accompanied in the interview by counsel.

*Oversight of Payments to Intermediaries.* Ms. Lancellotta noted that the SEC's 2014 examination priorities include a focus on payments by fund companies to financial intermediaries. Mr. Baumgardner observed that transfer agency and shareholder servicing models and pricing have become increasingly complicated in recent years. He noted that a fund group may rely on several different providers, with different pricing approaches, to provide recordkeeping and servicing to fund investors. He remarked that fund companies often have little influence on how a broker-dealer firm or retirement platform that is investing in mutual funds elects to provide recordkeeping and servicing to investors. He also pointed out that the services provided by the recordkeeper of an omnibus account may be more extensive, or of higher quality, than the services that a fund's own transfer agent would provide. He expressed the view that a more comprehensive scope (or higher quality) of services might justify a fund paying an omnibus recordkeeper a higher fee than it pays for basic transfer agency functions. Mr. Baumgardner also noted that, as larger percentages of fund assets are held in omnibus accounts, the economics of traditional transfer agency businesses are changing, and that transfer agents' ability to provide high-quality services to a dwindling base of non-omnibus account holders is an area of increasing attention from fund boards.

*Oversight of Alternative Funds.* Mr. Pugliese addressed some of the challenges that fund boards face when overseeing funds that make alternative investments, including (i) understanding the funds' investment strategies and the types of investment instruments and techniques the funds employ; (ii) understanding an investment adviser's capabilities to manage alternative portfolios and provide ancillary services such as valuation, accounting and tax services; (iii) setting appropriate benchmarks for evaluating the investment success of alternatives portfolios; (iv) assessing an adviser's capabilities to operate a registered investment company portfolio (including compliance-related matters in particular), if it does not have prior experience doing so; (v) overseeing risk management; and (vi) understanding the distribution strategy, including how the product and its related risks will be explained to intended investors.

Ms. Pike noted that constructing an appropriate peer group against which to measure the performance and the reasonableness of the fee structure for an alternatives portfolio is often challenging, because there may be relatively few funds that are pursuing comparable strategies. The panelists also noted that some boards hold special educational sessions, before the formation of funds that will employ alternative investment strategies, to help develop a better understanding of the strategies and of the special compliance and oversight challenges that these funds present.

*Oversight of Investment Performance.* The panelists then discussed a number of more general issues relating to board oversight of funds' investment performance. Mr. Pugliese said that boards can often exert a favorable influence over investment performance, by providing diligent oversight and by insisting that the adviser dedicate appropriate resources to portfolio management and take action to address disappointing performance. Ms. Pike noted that, in larger fund groups, it is increasingly common for boards to divide into two or more subcommittees to oversee investment performance, with each subcommittee taking primary responsibility for the oversight of the performance of a particular subset of funds.

*Fund Governance.* The panelists concluded by discussing a number of governance matters. Mr. Baumgardner said that the practice of annual board self-assessments has been "incredibly constructive in bringing to the fore" issues that warrant board attention, such as whether the board has an effective and appropriate committee structure. With respect to board succession planning, Mr. Baumgardner said that, in his experience, when contemplating recruiting new members to replace directors who are retiring, boards are increasingly asking themselves what skills and qualifications could usefully be added to the board. He contrasted this approach with the typical practice of 20 years ago, when the focus was more commonly on a prospective director's general experience rather than on specific skills that might enhance the board's ability to provide effective oversight. Mr. Pugliese noted the practice of some boards of designating particular directors to serve as liaisons to management with respect to particular topics that might require attention in the intervals between scheduled board meetings, such as compliance or investment matters.

## Session 2-B — The Regulation of Retirement Products and Services: Full Steam Ahead

*Moderator*: **Elena Barone Chism**, Associate Counsel, Pension Regulation, Investment Company Institute

*Speakers*: **Bradford P. Campbell**, Counsel, Drinker Biddle & Reath LLP
**James M. Delaplane Jr.**, Principal, ERISA and Fiduciary Services, Legal, Vanguard
**Margaret H. Raymond**, Vice President and Managing Counsel, T. Rowe Price Associates, Inc.

This panel discussed current legislative and regulatory initiatives that would have an impact on retirement products and services.

*Fiduciary Rule Proposal.* Ms. Raymond summarized the status of regulations proposed by the Department of Labor (the "DOL") that would dramatically expand the categories of persons deemed to be "fiduciaries" by reason of providing investment advice to plans for compensation under the Employee Retirement Income Security Act of 1974 ("ERISA"). She noted that the controversial regulations were initially proposed in October 2010 and subsequently withdrawn by the DOL in September 2011 in response to broad criticism from the financial services industry and input from Congress. Among the criticisms levied in response to the proposal were that the proposal was unnecessary or overly broad, that it could subject the sales activities of broker-dealers to fiduciary standards with respect to commission-based compensation, that it would adversely affect the ability of plans and service providers to rely on existing prohibited transaction exemptions, that it should not apply to IRAs, and that the DOL's economic analysis was insufficient and flawed. Mr. Raymond noted that the DOL most recently indicated that it would issue a re-proposal in August 2014 following a number of prior delays. The consensus of the panelists, however, was that the re-proposal will not be issued until after the November 2014 elections in light of the political focus and sensitivities involved.

Ms. Raymond discussed possible tensions between the DOL's fiduciary rule proposal and the SEC's rulemaking initiatives under the Dodd-Frank Act regarding a uniform fiduciary standard for investment advisers and broker-dealers, including the differing standards that would apply under the regimes to broker-dealers that receive commission-based compensation. She noted that H.R. 2374, adopted by the House Financial Services Committee in June 2013, would delay implementation of a DOL rule until 60 days after the SEC issues a final rule governing standards of conduct for broker-dealers, citing the need to avoid dueling or excessive standards. The panelists agreed that H.R. 2374 has little chance of passage in the Senate, but demonstrates the significance of the issues involved.

*Suitability Standards.* Mr. Delaplane discussed FINRA Notice 13-45, which reminds brokers of suitability standards when recommending a rollover of employer-sponsored retirement plan assets to an IRA, noting that this topic is a FINRA examination priority. He noted that the guidance assumes that a broker-dealer has suitability obligations when recommending available options for plan participants leaving an employer, even though no purchase or sale of securities may be taking place. Mr. Campbell expressed the view that the guidance creates uncertainty for broker-dealers as to their obligations and may make it more difficult for individual plan participants to receive advice when making decisions regarding their retirement savings.

*Target Date Funds.* Ms. Raymond estimated that the DOL's proposed rules regarding target date fund disclosures, initially proposed in November 2010, would be adopted prior to the adoption of related SEC rules proposed in 2010 (following a joint public hearing of the DOL and SEC in 2009). She noted that the SEC's Investor Advisory Committee recommended expansion and revision of the SEC's proposed rules in April 2013, including the recommendation of requiring a standardized "glide path" illustration based on risk rather than asset allocation, which would differ from the DOL's proposal relating to glide paths.

*Brokerage Windows.* The panelists discussed whether regulatory guidance on fiduciary requirements and regulatory safeguards are appropriate for the use of "brokerage windows" (i.e., self-directed brokerage accounts that enable participants to go beyond a plan's menu to select investments) in individual account plans, noting that the DOL is expected to issue a Request for Information on this topic in April 2014. The panelists noted that the DOL expects to issue a rule proposal in August 2014 that would require plan administrators to include lifetime income illustrations on participants' retirement account statements and discussed the complexities associated with making such estimates based on both current and projected account balances, as suggested in the DOL's advance notice of rulemaking (issued in May 2013).

*MyRA Program.* The panelists discussed various legislative initiatives designed to increase retirement savings and overall participation and access by employees. Ms.

Chism discussed the new My Retirement Account ("myRA") program unveiled by President Obama in his State of the Union Address in January 2014, noting that the U.S. Treasury expects to begin a pilot program in late 2014. Mr. Delaplane noted that the myRA program, which would be optional for employers, would allow participating employees to invest in U.S. Treasury securities through a Roth IRA with a minimum contribution of $25 and no associated fees. The panelists agreed that myRA will represent a modest measure with limited impact on overall savings levels and participation (with individual myRA accounts "maxing out" at $15,000 or 30 years of contributions), but could pave the way for more meaningful auto-IRA legislation.

*Camp Tax Reform Discussion Draft.* Mr. Delaplane discussed possible tax reform initiatives in Congress that may impact and limit existing tax incentives for qualified retirement plans. He summarized the Camp Tax Reform Discussion Draft, which would, among other features, freeze cost of living adjustments on contribution and deferral limits for tax-favored retirement plans through 2023, prohibit new SEP and SIMPLE 401(k) plans and new contributions to traditional IRAs, eliminate income limits on contributions to Roth IRAs, and significantly limit the use of "stretch IRAs," which allow IRAs to be passed to multiple generations with continuing tax deferred status. The panelists agreed that the Camp Tax Reform Discussion Draft is politically unlikely to move forward, but that various aspects of it may serve as a template for future legislation.

## Session 2-C — Off the Beaten Path: How to Avoid Missteps When Investing in Emerging and Frontier Markets

*Moderator*: **Eva M. Mykolenko**, Associate Counsel, International Affairs, Investment Company Institute

*Speakers*: **Russell L. Biles**, Chief Compliance Officer, Secretary, and Counsel, Wasatch Funds Trust
**Thomas C. Bogle**, Partner, Dechert LLP
**Liliane Corzo**, Vice President and Senior Counsel, The Capital Group Companies, Inc.
**Nancy G. Stetson**, Senior Vice President, Brown Brothers Harriman & Co.

The panel identified potential issues and provided practical insights for asset managers that invest significantly in emerging and frontier markets.

*Portfolio Management Considerations*. Mr. Biles highlighted several 1940 Act considerations that arise when structuring a fund to focus on emerging and frontier markets:

- *Names Rule (35d-1)*: The determination of whether individual companies are "tied economically" to a region places pressure on geographical line-drawing and financial analysis. In response to SEC staff comments, Mr. Biles's firm developed a multi-factor manual test, which includes analysis of where companies derive their income, for determining how to allocate individual companies among countries.

- *Concentration*: Because multi-nationals often are significant players in emerging markets, an emerging markets fund can unwittingly be drawn close to the 25% threshold for industry concentration, depending on how broadly it defines individual industries. Mr. Biles's firm opted to use the more granular GICS industry classifications instead of the Russell classifications. If a fund relies on manual overrides as to industry classifications for individual companies, it is critical to make sure the automated compliance screens are consistent in picking up all relevant tickers, SEDOLs, and other security-identification systems.

- *Liquidity and Best Execution*: Limited liquidity in emerging and frontier markets puts pressure on the trading desk. Where a fund might hold the equivalent of several days' market volume for some thinly traded stocks, it may be necessary to hold additional cash and/or make use of lines of credit when seeking to liquidate positions. When putting new cash to work, traders may have difficulty acquiring sufficient positions without disrupting local markets and pushing up prices. This underscores the importance of board reporting on execution, including with respect to FX trading.

- *Valuation*: Frequent trading halts, local holidays, illiquid markets, and time zone arbitrage create challenges when conducting valuations in emerging and frontier markets.

- *Russia and Similar Current Geopolitical Events*: The panel discussed the SEC staff's recent informal outreach to managers of funds with significant holdings in Russia, and concluded that it not good practice to sticker prospectuses every time there is a geopolitical event. Ms. Stetson noted concern that Russia may impose sanctions on foreign investors into Russia, which could encourage increased use of depositary receipts.

*OFAC Compliance.* The OFAC sanctions regime prohibits investing in sovereign debt of sanctioned jurisdictions and investments that finance sanctioned activities. Mr. Bogle noted that one point of confusion and frustration is that OFAC restricts investment into companies with "profits derived predominantly from" sanctioned activity, but has refused to clarify how to apply that standard. He highlighted the 2012 Genesis settlement with OFAC, where a U.S. adviser invested into a Cayman fund that then invested into Iran. Prohibited financing activities also include indirectly financing activities in which U.S. persons would be prohibited from engaging directly. When trying to avoid landmines in OFAC compliance, which effectively imposes strict liability for even unwitting violations, U.S. managers should consider carefully examining the use-of-proceeds discussions in debt offering documents and placing great importance on the identity of the underwriters of debt offerings (large investment banks typically have well-developed OFAC compliance programs). He noted that side letters are desirable but not always possible, and that looking to the numbers and composition of other investors in an offering may provide some comfort. Mr. Bogle warned that managers should consider the Foreign Corrupt Practices Act, especially when taking control positions in companies.

*Local Law Challenges.* The panel reviewed several challenges in dealing with local laws:

- *New Laws*: Ms. Corzo observed that there is often little transparency in the lawmaking process in emerging markets, and new laws can come into force without warning or a transition period. Inconsistencies, unpredictable interpretations, constant changes, and language barriers all conspire to confound U.S. managers trying to comply with local laws.

- *Regulatory Approvals*: Ms. Stetson outlined complications where foreign investors need approval before entering into some countries, such as Brazil, Colombia, and China. Some requirements do not easily fit U.S. structures, such as Vietnamese requirements that individual funds place their seal on official documents.

- *Ownership Reporting*: Different countries impose different thresholds for initial and subsequent filing obligations for securities ownership reports. Countries differ on whether the filer needs to be the beneficial owner or the manager with discretionary authority. Timing requirements can be tight. It may be helpful to accompany filings with a clear cover letter explaining the identities and relationships of all parties related to the ownership interest triggering the filing.

- *Investment Limits*: Some countries impose substantive limits on investments in particular industries or require prior regulatory approval before making such investments. Occasionally it is possible to use local counsel to seek exceptions from the stated limits, though managers should be aware that even confidential discussions may ultimately become known publicly.

*Additional Considerations.* The panel reviewed several practical challenges in investing in emerging and frontier markets. Opening of trading accounts can be complicated and time-consuming, especially for non-corporate entities such as business trusts or funds with an umbrella and sub-fund structure. There can be complications in appointing administrators, agents for handling communications and proxies, tax consultants, and other agents in many countries. Divergent practices as to trade settlement can introduce additional risks and 1940 Act complications, as few markets in emerging countries offer true “delivery versus payment” settlement. Additionally, FX controls significantly complicate investing in important markets such as China and Taiwan.

## Session 2-D — Blurred Lines: Alternative Strategies in the Retail Funds Market

*Moderator*: **Emilie D. Wrapp**, Senior Vice President and Head of Mutual Fund Legal, AllianceBernstein

*Speakers*: **Kenneth Barbuscio**, Managing Director and Head of Platform Development, USWA Platform Development Team, BlackRock
**Andrew Clark**, Manager of Alternative Investment Research, Lipper, A Thomson Reuters Company
**Kenneth S. Gerstein**, Partner, Schulte Roth & Zabel LLP
**Jane Jarcho**, National Associate Director, Investment Adviser/Investment Company Examination, U.S. Securities and Exchange Commission

This panel focused on the challenges associated with the increasing use of alternative strategies in the retail funds market and the SEC's impending examination of alternative funds.

*Trends in the Use of Alternative Strategies.* Alternative funds, which are typically used to reduce risk and/or enhance returns, have grown from around $50 billion in assets under management in 2009 to nearly $300 billion in assets under management at the end of 2013. Most of these assets sit in closed-end funds of hedge funds or, more recently, multi-manager mutual funds with absolute return, long/short equity, global macro, or credit focused strategies. The panelists posited that asset flows into alternatives would continue to increase as financial advisors and investors become increasingly educated on these products.

*Challenges Associated with Liquid Alternative Strategies.* Mr. Barbuscio discussed challenges associated with entering the liquid alternatives space, noting the difficulty that investment managers have faced with respect to liquidity constraints, asset allocation, sourcing money, tax implications, and the lack of transparency into underlying assets. Mr. Barbuscio described the process undertaken by his firm to research the alternatives market, educate advisors and investors, and bring alternatives products to market to fill client needs.

Mr. Gerstein explained that private fund managers are using alternative funds to break into the registered fund space in order to diversify their businesses and broaden their product offerings. Due to the high cost of launching a registered fund and establishing the necessary operational and compliance infrastructure and distribution network, many private fund managers are familiarizing themselves with the registered fund space by sub-advising for asset managers that have an established registered fund practice. Mr. Gertstein noted the steep learning curve for private fund managers with respect to disclosing firm financial and other information during the 15(c) process, providing on-going reporting to the fund's board of trustees, and navigating the investment restrictions that differ from those of private funds (e.g., liquidity restrictions, limitations on affiliated transactions, asset segregation and coverage for derivatives, trade error liability, and soft dollar usage). He noted the critical need for advisers to multi-manager funds to establish comprehensive policies and procedures, allocate investment budgets among sub-advisers, and conduct sleeve-level and fund-level testing.

*SEC to Examine Alternative Funds.* Ms. Jarcho noted that, given the growth in this area, alternative funds are among the SEC's exam priorities for 2014. The SEC is in the final stages of putting together a national sweep exam that is expected to begin this summer and last through the end of 2015. The initiative, which will target 15 to 20 fund complexes in its first phase, will focus on compliance, leverage, liquidity, and board oversight. Ms. Jarcho noted that the SEC will target funds across various strategies, the size of the adviser will not be a factor in which funds the SEC will target, and a complex that has recently undergone a general examination may still be subject to the alternatives exam.

## Keynote Address

*Speaker*: **Craig M. Lewis**, Director, Division of Economic and Risk Analysis, U.S. Securities and Exchange Commission

As the Director of the Division of Economic and Risk Analysis ("DERA"), Mr. Lewis has worked toward bolstering economic analysis in connection with SEC rulemaking. During his keynote address, Mr. Lewis described the impact of DERA's development of economic analysis at the SEC and provided examples of its value in the rulemaking process.

On March 16, 2012, DERA and the Office of the General Counsel issued a paper entitled *Current Guidance on Economic Analysis in SEC Rulemaking* (the "Guidance"). The Guidance lays out the basic principles of economic analysis and sets forth the precept that economists should be part of the rulemaking process from the start. Mr. Lewis believes that the Guidance has focused and enhanced how the SEC and its staff approaches economic thought.

Mr. Lewis noted that the Guidance explains the four basic elements of economic analysis: identification of the need for the regulatory action; articulation of the baseline against which any potential economic effects can be measured; explanation of alternative approaches to reaching the regulatory goal; and consideration of the economic costs and benefits of the regulatory action. The Guidance concludes with a discussion of the importance of the integration of economic analysis into the rulemaking process. Mr. Lewis attributed the success of the Guidance to the SEC staff who assisted in its implementation.

During the rulemaking process, DERA has described market conditions, analyzed capital raising activities, and assessed the economic trade-offs associated with regulation. Mr. Lewis pointed out that, in addition to its involvement in the rulemaking process, DERA has become involved in a variety of other initiatives at the SEC and has published many pieces of original research, which are featured on the DERA website.

To illustrate DERA's role in rulemaking, Mr. Lewis described DERA's involvement in money market fund reform, noting (i) the qualitative and quantitative analysis in the proposing release involving, for example, the features of a money market fund that create incentives for shareholders to redeem in periods of financial stress and the economic consequences of floating NAV and liquidity fees; and (ii) the additional data analysis included in the comment file regarding capital buffers and the appropriate size of diversification limits in money market funds.

Mr. Lewis noted that DERA will continue to engage in robust and transparent economic analysis in rule proposals and encouraged industry participants to submit comment letters that contain not only policy discussions, but economic analysis of the SEC's proposed rules. In response to an attendee's question, he described his aspirations for DERA's future as involving two core elements: (i) continuing DERA's participation in the rulemaking process with a stable set of economists that view the SEC as a career, not a way station on the way to academia; and (ii) using its expertise in data analytics to develop risk assessment tools to assist OCIE with enforcement cases.

## Session 3-A — Cybersecurity—Do You Know Who Has Your Data?

*Moderator*: **Peter G. Salmon**, Senior Director, Operations and Technology, Investment Company Institute

*Speakers*: **David A. Jordan**, Global Head of Information Security, Risk, and Controls, Invesco Ltd.
**Joseph Nocera**, Principal, PricewaterhouseCoopers
**John L. Shea**, Chief Information Officer, Eaton Vance Management
**Daniel T. Steiner**, President, ICI Mutual Insurance Company

This panel discussed cybersecurity issues and the growing importance of robust cybersecurity programs as threats to data security increase.

*Cybersecurity Threats.* Mr. Salmon introduced the panel by noting the recent attention to cybersecurity issues by regulators, including the SEC. He stated that for mutual fund firms, data security was complicated by the fact that important and sensitive data was held by many different service providers to a fund, including, for example, investment advisers, custodians, and transfer agents. Mr. Salmon discussed the types of actors that might seek to procure sensitive data illegally, categorizing the four groups from which threats are likely: nation-states, organized crime, "hacktivists," and insiders. The panelists discussed the motives for each such group to misappropriate data.

Mr. Jordan said that fund firms were aware of the changing nature of cybersecurity threats, and approached cybersecurity differently than they had in the past. In particular, he said that firms no longer viewed cybersecurity as solely an information technology department issue, but rather as an issue warranting the attention of the board and chief executive. He also noted a shift away from an approach that emphasized protecting the perimeter of a firm's data to one that recognized that the perimeter was fuzzy (especially in light of the use of mobile devices), and therefore a more useful approach was to plan for, monitor, and respond quickly to data breaches.

*Cybersecurity Considerations for Mutual Fund Firms.* Mr. Salmon discussed cybersecurity considerations for mutual fund firms, including the need for funds to be able to explain their cybersecurity program to shareholders and regulators. Mr. Jordan discussed the importance of having a risk mitigation priority list so that resources could be focused on areas of primary concern. He said that this involved identifying the location of key "assets" that cyber-attackers may seek. In addition to the priority list, he also recommended instituting a well-practiced incident response system. In this regard, he said there are a plethora of sources of real-time data regarding cybersecurity threats – and that sometimes there can be too much data available, resulting in a problem of "false positives."

Another important issue for mutual fund firms, Mr. Salmon said, is oversight of third parties that hold sensitive data regarding the fund or its shareholders. Mr. Shea said that his firm used a "trust but verify" approach, and that recently the emphasis on the "verify" component of the approach had increased. He said that part of the implementation of a robust cybersecurity program included revisiting contracts with third parties to understand key terms, such as liability and notification provisions. Such a program would also include diligence and periodic briefings on cybersecurity programs from key third party service providers.

Mr. Shea discussed the threat posed by insiders unknowingly permitting access to firm data as a result of social engineering attacks, such as phishing, voice phishing (or "vishing"), or corrupted USB keys. Mr. Shea said that the importance of education to combat these efforts could not be overstated, highlighting programs his firm has used such as testing employees through "ethical phishing" and locking down USB ports on firm computers.

*Cyber Insurance.* Mr. Steiner next discussed the role of cyber insurance. He said that cyber risk is best conceived of as a class of risks, some of which are transferable through insurance and some of which are not. Of the risks that are transferable, some may be covered by general insurance policies and others can only be covered by specialty policies that have begun to emerge over the past decade or so. For example, an employee hacking a network may be covered by a firm's fidelity bond, but coverage for a privacy hack by an outsider might require a specialty policy. He noted that insurance is only one type of risk transfer option, and noted that firms could also look to third party contracts to allocate risks appropriately. He also noted that some of the biggest risks from cybersecurity attacks are reputational, and those risks generally cannot be transferred.

A discussion followed regarding cyber insurance, during which Mr. Steiner said that more fund firms have recently contemplated specialty insurance policies for cyber risk because of the growing awareness among firms and regulators of the threat, fueled in large part by well-publicized data breaches. Mr. Nocera said that, over time, as actuarial data gets more robust, he would expect to see development of best practices that reduce premiums for such coverage. He discussed the difficulty in determining the appropriate coverage amounts, saying that while firms could look to peer costs of data breaches (e.g., costs of investigation, legal defense, and remediation), it is hard to value certain types of losses, such as reputational and intellectual property losses. Mr. Steiner said fund firms could look at "peer profiles" of the coverage peer firms are procuring, but said that there might not be sufficient sample sizes at this point.

*Other Issues.* The panelists engaged in a broad-ranging discussion regarding a number of other cybersecurity issues, such as resetting passwords on mobile devices that are loaned to employees for travel (instead of discarding them); appropriate reporting structures for the head of data security (with a consensus that there was no single required structure, so long as the business as a whole was engaged); the level of engagement of mutual fund boards (with a consensus that boards had become more involved in recent periods in understanding the threats posed); and whether firms should have cybersecurity policies (Mr. Jordan noted that several frameworks for such policies existed).

With regard to the question of which entity or entities would be responsible for the costs of a data breach in a mutual fund context, Mr. Steiner suggested that if the breach occurred at a financial intermediary, that company would likely be responsible. Mr. Nocera said that ultimately the stakeholder who had the primary relationship with the party whose data was compromised would likely be responsible. He said that such firm might look for reimbursement from other parties as a result of contractual provisions, but should expect to take the lead in responding to the breach.

## Session 3-B — Accounting and Auditing Update

*Moderator*: **Gregory Smith**, Senior Director, Fund Accounting and Compliance, Investment Company Institute

*Speakers:* **Jaime L. Eichen**, Chief Accountant, Division of Investment Management, U.S. Securities and Exchange Commission
**Brent Oswald**, Partner, KPMG LLP
**Jessica Seidlitz**, Managing Director, Fund Accounting, Charles Schwab Investment Management, Inc.
**Austin Wachter**, Senior Director, Investment Accounting, TIAA-CREF

This panel discussed recent accounting guidance and accounting issues that may affect funds.

*PCAOB's Release 2013-005*. Mr. Wachter reviewed the PCAOB's Release 2013-005, which was intended to make auditors' reports on financial statements more helpful to the investor community. Among other things, the proposal would require an auditor's report to discuss certain critical audit matters (i.e., those matters involving the most difficult, subjective, or complex judgments by the auditor in forming the auditor's opinion on the issuer's financial statements). Mr. Wachter stated that the industry had a number of concerns with this aspect of the proposal because the responsive disclosure could be lengthy and suggest, often incorrectly, that a problematic audit issue was present. He noted that many industry participants expected that this standard would require disclosure in the auditor's report regarding a significant deficiency or a material weakness in internal control over financial reporting.

Mr. Wachter also reviewed certain other less controversial aspects of the proposal, including new requirements regarding disclosure about the auditor's tenure working with the issuer and the auditor's independence. Mr. Wachter stated that the proposal would also require auditors to apply a higher level of review to the non-financial statement portion of the shareholder reports. He said that the proposed standard was to "read and evaluate" for material inconsistencies and material misstatements of facts, changed from the lower standard of "read and consider." He stated that many industry participants believed that this higher standard would require additional work papers and procedures to document the completed evaluation.

During the panel discussion that followed, Mr. Smith noted that many facets of the proposal, especially the disclosure of critical audit matters, were arguably inappropriate for mutual fund issuers given the relative simplicity of their financial statements compared to those of operating companies. Mr. Wachter remarked that many of the comments on the proposal noted that the costs of complying with the higher standards may exceed, potentially significantly, the benefits of the higher standards.

*ASU 2011-11.* Ms. Seidlitz discussed ASU 2011-11 and the related required disclosures about offset arrangements. She noted certain unusual issues arising out of the application of ASU 2011-11, including that there were limits on disclosing excess collateral held by a fund, which leads to certain parts of the financial statements not tying out to other parts. She noted that the financial statement disclosure was dependent on the analysis of certain legal issues, such as the interpretation of ISDAs, which complicated matters for auditors. She stated that the disclosures she has seen regarding offset arrangements were often lengthier than other seemingly more important disclosures, such as those regarding an issuer's valuation policies.

The panel discussed certain operational issues that made the application of the standards difficult, including centrally cleared swaps, repurchase agreements, and securities lending. Ms. Seidlitz said that the guidance provided for ASU 2011-11 was intended for operating companies that typically net their exposures, not for registered investment companies that typically include their investment exposures on a gross basis. Ms. Seidlitz noted that funds with manager-of-manager arrangements raise additional issues because it is unclear whether offsetting arrangements should be discussed at the fund or manager level for purposes of the disclosure. Ms. Eichen said the staff will look at the first round of ASU 2011-11 disclosures in reports filed for the period ended December 31, 2013. She stated her expectation that the staff would give its feedback on that first round of disclosure to the AICPA expert panel, which would then be asked to communicate that feedback to the industry.

*Commodity Pools.* Mr. Smith provided a report regarding financial reporting for commodity pools. He noted that the CFTC's Rule 4.2.2 requires the distribution of a monthly account statement, a statement of operations, and statement of changes in net assets. He cited certain key differences between the CFTC's and the SEC's requirements with respect to an issuer's financial statements, including that CFTC standards require additional data be presented on an issuer's balance sheet and statement of operations, that brokerage commissions paid on trades must be itemized, that issuers must provide disclosures on investee funds that exceed 5%, that issuers must disclose income and management fees for each such investee fund, and that an issuer's financial statements must aggregate information for all investee funds below the 5% threshold. Mr. Smith noted that the harmonization rules provide for substituted compliance for SEC-registered entities that eliminates the monthly account statement requirement. He stated that similar relief from the annual report requirement has been requested by the ICI.

Mr. Smith noted that new requirements mandate that issuers enter certain key financial data into the NFA's reporting system. He explained that the system serves as an early detection system for the NFA and that the NFA intends to use that data to screen filings quickly. He noted that the data required is not tailored for mutual funds, so a level of judgment is required in determining an issuer's responses. He suggested filers evaluate carefully their responses and document the reasons for their responses.

*Staff Update.* Ms. Eichen provided a number of updates regarding issues of concern for the staff and reminded industry participants that those making written consultation of the staff must first provide the conclusions of the issuer's audit committee, independent auditors, and management regarding the issue on which the staff's views are sought. Ms. Eichen reviewed the efforts of a staff task force focused on financial reporting and accounting fraud. She noted that fraud is typically more prevalent on the private fund side of the industry and often is effected through related-party transactions, such as charging expenses that are not permitted by a fund's offering or organizational documents. She urged the auditing community to scrutinize closely related-party transactions, especially series of complex business transactions that do not have a clear business purpose. Ms. Eichen also stated that valuation is a continuing concern of the staff, and that some issuers value investments at other than exit price, such as at cost or at the value of an expected payment at maturity. She stated that defaulting to cost or par for valuation is inappropriate even if market value is close to cost or par.

Ms. Eichen said the staff has concerns that certain derivative instruments based on custom baskets of securities or indices have management and incentive fees embedded into their terms, such that the fees are embedded in the profit and loss figures and, therefore, are not transparent. She stated that good disclosures for such instruments would include separate disclosure regarding the relevant reference assets, fees, and appreciation and loss on the investment portion of the transaction. Ms. Eichen noted that the staff was requesting that applicants seeking relief under Rule 19b-1 under the 1940 Act should submit draft requests for relief to IMOCA@sec.gov before filing formally with the SEC.

## Session 3-C — Global Trends in Fund Distribution: The Growing Regulatory Focus on Intermediary Compensation

*Moderator*: **Giles Swan**, Director of Global Funds Policy, ICI Global

*Speakers*: **James Hammond**, Managing Director–Europe, Franklin Templeton
**Kelley Howes**, Of Counsel, Morrison & Foerster LLP
**Blair C. Pickerell**, Chairman, Asia, Nikko Asset Management
**Shiv Taneja**, Managing Director, Cerulli Associates Europe Ltd.

The panelists in this session provided their views on recent regulatory developments regarding the role and compensation of distribution intermediaries across the globe.

*Industry Consolidation and Competition.* Mr. Taneja remarked on the recent consolidation in the global fund industry, noting that the top 50 firms now account for 55% of global assets under management and the top 10 firms account for 37% of global assets under management. Mr. Taneja commented that, despite the consolidation, there was increased competition in the fund industry (e.g., competition between active and passive funds, alternative and transitional funds, and consultants and asset managers). He stated that funds are focusing on multi-asset products rather than multi-manager products, and noted that, in recent years, advisers' focus on the bottom line has been tempered with an emphasis on reputation and recognition that "growth at any cost" is not a viable strategy. Mr. Hammond noted that multi-asset products were increasingly becoming default products for defined contribution schemes.

*Distribution in Asia.* Mr. Pickerell remarked that there is "virtually no cooperation" among Asian countries with respect to the distribution of fund shares, and that no Asian country allows funds from other Asian countries to be sold to its retail market. Mr. Pickerell noted that most funds in Asia are distributed by commercial banks, with private banks and insurance companies playing a smaller role. He explained that the population trusts banks and many fund management companies are unaware that certain distributors offer to distribute funds on a "no load" basis.

Mr. Pickerell noted that fees are relatively high in Asia, primarily because clients are not proactively looking for funds – instead, funds are "pushed on clients" by intermediaries. He reported that the average annual management fee is 150 basis points or more and distributors are likely to seek distribution fees of 75 basis points from new entrants. In addition to the distribution fee, distributors are likely to charge clients a front-end fee (100% of which is typically retained by the distributors) and are fairly aggressive in their requests for advisers' time for promotional activities. Mr. Pickerell noted that he had heard of well-known distributors having rejected funds from their platforms because fees were too low.

Mr. Pickerell remarked that Asian investors tend to trade funds frequently rather than hold them, a trend that is compounded by distributors that are "addicted to front-end loads." Mr. Pickerell stated that many Asian fund managers have distribution capabilities, but perhaps not the investment capability or credibility to manage funds, and that sub-advising is a viable strategy for penetrating Asian markets. He noted that $27 billion of his firm's $160 billion in assets under management had been allocated to 44 other managers to sub-advise.

Mr. Pickerell contrasted the distribution channels in China and India, both fast developing markets with large populations and long-term growth potential. He explained that, in China, four or five banks dominate the market, accounting for 80% of fund launches. The key to distribution in China is convincing the head office of one of these banks to list a fund for distribution at their thousands of offices. Conversely, in India, even a small management company would have a distribution relationship with 6,000 intermediaries. India's largest fund management company has 179 offices just to service its intermediaries. He further noted that, in India, a foreign firm can own 100% of a fund management company, whereas in China foreign firms may only take a minority stake.

Mr. Pickerell remarked that he did not think Hong Kong passporting into China would be as important as expected. He noted that the trial was heavily driven by the Hong Kong government and China wanting to appear friendly and that any trial passporting would come with restrictions, including seed capital requirements and a year-long track record.

*Distribution in the UK.* Mr. Hammond explained that the fund distribution market in the UK is dominated by independent financial advisers ("IFAs") (approximately 80-88% of mutual funds are sold through IFAs). He noted that there had been a 16% reduction in advisers in the UK following the implementation of the UK's Retail Distribution Review ("RDR"), a set of rules aimed at introducing more transparency and fairness in the investment industry, which came into force 14 months ago and banned trail commissions for financial advisers. He stated that while RDR had a substantial impact, because the ban on trail commissions was predicted long before its implementation, IFAs had been increasingly moving their business models from commission-based to fee-based models.

Mr. Hammond explained that, while the Markets in Financial Instrument Directive II ("MiFID II") proposes banning inducements for IFAs, it does not currently ban commissions for non-independent advisers. Spain and Italy continue to be dominated by retail bank distributors and, as such, commissions can still be paid. However, Mr. Hammond noted that Netherlands has banned commissions and he believes that commission bans are likely to be imposed throughout Europe.

Mr. Hammond explained that, at the top end of the market, clients are accustomed to paying for advice; however, the mass market is moving towards “self-direction.” Online advisers are becoming increasingly popular where investors can answer questions and be provided with a model portfolio they can purchase via a platform. Mr. Hammond noted that, as an investor’s assets increase, the investor is more likely to pay for advice.

*Distribution in the United States.* Ms. Howes remarked that in 2010 the SEC proposed Rule 12b-2, noting that managers were increasingly offering “no load” and “low load” products. At the same time, there was a trend towards intermediated distribution. According to the ICI Fact Book, 82% of U.S. investors invest through a financial intermediary. Ms. Howes noted that U.S. regulators have not publicly discussed an outright commission ban, but the existence of front-end payments is dwindling as a result of market dynamics.

Ms. Howes described another current regulatory focus, “reverse churning,” whereby advisers place low balance accounts and infrequently traded accounts on a fee-based platform instead of a transactions-based platform in order to generate an ongoing revenue stream. She noted that regulators are increasingly focusing on reverse churning. She noted that a broker-dealer’s standard of conduct is one of suitability, whereas advisers have a fiduciary obligation to act in a client’s best interests. Advisers may argue that putting an account on a fee based platform may be suitable, but reverse churning may not always be consistent with the higher fiduciary duty of an investment adviser towards its clients.

Ms. Howes stated that one of the primary ways to pay for distribution in the U.S. is by revenue sharing, payments from advisers to intermediaries out of the adviser’s legitimate profits. Ms. Howes noted, however, that U.S. asset managers are facing regulatory scrutiny as to whether fees that are not characterized as distribution fees are in fact being used to pay for distribution.

*Understanding and Selling the Product.* Mr. Hammond noted that regulators are increasingly focused on whether sales people understand the products they are selling. He noted that regulators are also accepting that complexity in product design does not automatically equal risk. Mr. Hammond explained that, under the Treating Customers Fairly (“TCF”) initiative, advisers increasingly are required to identify the type of clients at which products are aimed. Such advisers are focused on training sales personnel in order to avoid accusations of mis-selling or misrepresentation. Mr. Pickerell noted that mis-selling is a prevalent regulatory topic in Asia as well. In Hong Kong, the government has heavily cracked down on mis-selling to the extent that banks are nervous about allowing staff to give substantive advice. Mr. Pickerell contends that this focus is harming the fund industry because banks are so afraid of a mis-selling accusation that they will conduct long interviews of clients to determine their risk profile and then record the interview in case of future claims.

## Session 4-A — The Evolution of FINRA and What It Bodes for Funds and Their Advisers

*Moderator*: **Tamara K. Salmon**, Senior Associate Counsel, Securities Regulation, Investment Company Institute

*Speakers*: **Carlo V. di Florio**, Chief Risk Officer and Head of Strategy, Financial Industry Regulatory Authority
**Thomas M. Selman**, Executive Vice President, Regulatory Policy, Financial Industry Regulatory Authority

The panelists discussed their roles at FINRA, with a particular focus on issues relating to investment companies and their investment advisers and distributors.

*Coordination with the SEC.* Mr. di Florio explained that FINRA is continuing to move towards risk-based enforcement and regulation, and now regularly analyzes large sets of data to identify trends or transactions that may involve risks to investors and markets. He discussed FINRA's strong and close relationship with the SEC staff. He cited the joint release regarding business continuity risk in the aftermath of Hurricane Sandy as an example of FINRA's close coordination with the SEC staff. Mr. di Florio stated that FINRA expected to continue to communicate with the industry through publication of its annual exam priorities and periodic risk alerts.

*Review of Rules.* Mr. Selman stated that FINRA was conducting a "refresh" review of its rules, and noted that FINRA's advertising rules would be among the first reviewed. He noted that FINRA's prohibition on the use of related performance in advertising materials other than with qualified purchasers investing in 3(c)(7) funds was "ripe for a refresh review."

Mr. Selman acknowledged that occasionally rules directed at full service broker-dealers may present issues for mutual fund principal underwriters. He noted that FINRA had recently proposed a new rule book for certain limited corporate financing brokers, but stated that there were no current plans to propose a new rule book for mutual fund principal underwriters.

Mr. Selman acknowledged that FINRA reviews of advertisements for open- and closed-end funds were time consuming, and cited increasing complexity of fund products as a significant driver of review times. He stated that FINRA currently had more advertising reviewers than in previous years, but that employee attrition remains a challenge. He urged firms experiencing issues to contact him.

*Fiduciary Standards for Broker-Dealers.* Mr. di Florio stated that FINRA supports the imposition of a fiduciary standard on broker-dealers, but believes that the issue is one for the SEC and the Department of Labor. He noted that a fiduciary standard is one side of a coin, the other side of which is the need for more frequent examinations of investment advisers. He said that FINRA has also discussed with the SEC staff whether certain broker-dealer rules, including suitability, should apply to investment advisers, and stated that FINRA is not specifically seeking to be designated as a self-regulatory organization for investment advisers.

### Session 4-B — Dawn of the New Regulatory Era: What Swap Regulations Mean for Funds

*Moderator*: **Jennifer S. Choi**, Senior Associate Counsel, Securities Regulation, Investment Company Institute

Speakers: **Christine Ayotte-Brennan**, Vice President, Associate General Counsel, Fidelity Management & Research Company
**William Thum**, Principal, Vanguard
**P. Georgia Bullitt**, Partner, Willkie Farr & Gallagher LLP

This panel focused on the new swap regulations implemented under the Dodd-Frank Act as they relate to registered funds. Ms. Choi observed that the CFTC has implemented most of the rulemaking required by the Dodd-Frank Act with respect to swaps trading, but the SEC has adopted very few of its rules. She noted that registered funds now must comply with numerous clearing and trading requirements, as well as recordkeeping rules, for swaps transactions.

*Clearing of Swaps*. Ms. Ayotte-Brennan described the extensive infrastructure development and other preparation undertaken by fund firms in advance of the introduction of mandatory clearing of swaps in the summer of 2013. Mr. Thum asserted that the transition to mandatory clearing had been a success primarily because (i) the deadlines had been phased in over time for different types of market participants, and (ii) the CFTC had actively engaged with the industry in the implementation. CFTC rules requiring the mandatory clearing of non-deliverable FX forwards and FX options are expected to be proposed in May, which could require mandatory clearing of these instruments by registered funds as early as late 2014.

*Trading on Swap Execution Facilities ("SEFs").* The panel agreed that the transition to mandatory trading of certain types of swaps on SEFs, which began in February 2014, had been disjointed and overly difficult, in part because the above-noted factors were absent. To date, 24 SEFs have provisionally registered with the CFTC. The panel described several glitches that frustrated efforts of well-prepared fund firms to transition to SEF trading: (i) account set-up arrangements routinely failed when initially trying to execute SEF trades through the futures commission merchant ("FCM") with whom a firm was already executing other types of cleared trades; (ii) registered fund complexes offer a number of different issues for SEF trading, such as entering bunched orders for multiple funds at an FCM, and the current SEF infrastructure often has been ineffective at accurately executing complicated trades; (iii) the SEF rulebooks initially circulated were flawed, and critical improvements (such as clarifying the different roles of the funds and the manager) came at the eleventh hour; and (iv) SEFs refused to negotiate the terms of their user agreements on a one-off basis, but instead updated their forms over time, such that, in some cases, fund firms signing up earlier ended up with worse terms. Mr. Thum encouraged firms that had signed their user agreements with SEFs earlier in the process to request an updated form agreement, as certain SEFs have not been volunteering to provide better terms to the early adopters who had signed on to agreements with less palatable terms.

Ms. Ayotte-Brennan argued that the risk limit rules on SEF trading are not a good substantive protection because (i) there is little transparency into how FCMs actually calculate the limits for individual funds; and (ii) FCMs routinely increase the limits upon request from managers whose funds approach the limit. Ms. Ayotte-Brennan observed that under SEF trading, an error at the FCM cannot be corrected as easily as it could under OTC trading, where the OTC counterparty would simply reverse the trade, but rather must be booked as a new, offsetting trade, which can expose the fund to market movements and risk of loss, as well as additional costs.

*Protection of Collateral.* Mr. Thum described the "legally separated operationally commingled" ("LSOC") regime for protecting cleared swaps collateral placed with FCMs as a very positive outcome for the fund industry. Under LSOC, the FCM sends the required minimum clearinghouse margin for cleared trades to the clearinghouse on a daily basis, so that if an FCM defaults or fails there is less margin with that FCM and the margin account can more easily be transferred to another FCM. Under a further enhancement known as "LSOC with Excess," an FCM moves excess margin (in addition to required margin) up to the clearinghouse, thus further reducing the amount of margin held by the FCM (and therefore subject to the risk of fraud by the FCM). Ms. Ayotte-Brennan observed that LSOC with Excess is only workable if a critical mass of market participants sign up for it, because excess margin held in an FCM's account at the clearinghouse would still likely be treated as part of the FCM's estate in an FCM insolvency and allocated *pro rata* among customers. Ms. Choi stated that three FCMs currently offer LSOC with Excess on the CME clearinghouse, one using the structure with both variation margin and initial margin, and that the same three FCMs are testing the use of LSOC with Excess on the LCH clearinghouse.

*Upcoming Regulations.* The panel outlined several upcoming regulatory changes. Ms. Bullitt described proposals by the Basel Commission and IOSCO regarding mandatory minimum margin requirements for uncleared swaps, noting that the proposals on margining could potentially cause a significant change in typical market practice because they would require both funds and dealers to post initial margin (in addition to variation margin). She also described the upcoming U.S. requirement for swap dealers to offer all counterparties the right to segregate their initial margin at a third party custodian, observing that swap dealers will have to provide annual notice of this right, will have to give funds a choice of custodian (which technically need not include a mutual fund's current custodian as one of the options), and will have to make sure there is an appropriate tri-party agreement in place.

*Custody Issues for Collateral*. Ms. Bullitt outlined several current custody-related issues for collateral in cleared swaps transactions. She noted that the SEC's no-action relief allowing collateral for cleared swaps to be held at a clearinghouse is due to expire at the end of 2014, and that the conflict between the clearing requirements under the Dodd-Frank Act and the 1940 Act custody requirements will need to be resolved on a permanent basis.

*Cross-Border Issues*. The panel discussed several cross-border issues related to swaps. Certain transactions are subject to both the CFTC rules and the European EMIR regime, which can be operationally unworkable in certain circumstances. Ms. Bullitt observed that the CFTC's "substituted compliance" regime and the EU's "equivalence" standard are going to be critical in working through broader cross-border issues. Ms. Ayotte-Brennan observed that European Market Infrastructure Regulation introduces a dual-reporting regime that obligates managers to report trades for funds and clients organized in the EU, but that initial efforts to submit reports through DTCC met with numerous technical glitches and breakdowns.

## Session 4-C — The 900-Page Gorilla: Implications of the Volcker Rule for Regulated Funds

*Moderator*: **Mara L. Shreck**, Head of Asset Management Public Policy, Global Regulatory Strategy and Policy, J.P. Morgan Chase

Speakers: **John L. Bronson**, U.S. Businesses Regulatory Counsel, Prudential Financial
**Satish M. Kini**, Partner, Debevoise & Plimpton LLP
**Jai R. Massari**, Associate, Davis Polk & Wardwell LLP
**James G. Whetzel**, Associate Vice President, Executive Attorney, USAA

This panel discussed the substantive requirements of the Volcker Rule and potential impact on investment funds.

*Exclusions and Exemptions.* Ms. Massari noted that there are many differences between the final statutory provisions and the rule originally envisioned by Paul Volcker. She explained that the rule generally prohibits "banking entities" from trading "financial instruments" as principal for a "trading account," but provides various exclusions and permitted activity exemptions, subject to conflict of interest and riskiness backstops. She explained that the term "trading account" is not an actual account, but instead is a concept intended to cover short-term trading (including positions entered into in a dealing capacity and positions held for short-term purposes). She said that among the exclusions that are most relevant to the asset management industry are exclusions for securities lending, trading under repurchase and reverse repurchase agreements, and agency, brokerage, and custodial activities. Moreover, key permitted activity exemptions for the industry include exemptions for market making-related trading activities, trading in U.S. government and, to some extent, foreign government obligations, and trading outside of the U.S. for foreign headquartered banks (referred to as the "TOTUS" exemption). She noted that the compliance requirements to rely on the permitted activity exemptions specifically, and the Volcker Rule more generally, are complex and the industry should expect that banks will be reevaluating their trading activities, including trading with funds, in light of these requirements.

*Covered Funds and Banking Entities.* Mr. Kini noted that, while the Volcker Rule was intended to apply to hedge funds and private equity funds, the final rule is broadly drafted. The rule has been structured so that any 3(c)(1) or 3(c)(7) fund is a covered fund subject to the Volcker Rule unless the fund fits into one of the specific fund structures that have been carved out of the general definition. He also noted that commodity pools with similar characteristics to 3(c)(1) or 3(c)(7) funds are covered funds. Due to the breadth of the definition of covered fund, some vehicles that are not private equity or hedge funds, such as venture capital funds or securitization vehicles, are covered funds unless they fit into an exception. He also explained that the reach of the Volcker Rule is different for U.S. and non-U.S. banks.

Mr. Kini explained that registered funds are excluded from the definition of covered fund, but there is no similar exclusion of registered funds from the definition of banking entity. As a result, a registered fund that is controlled by a banking entity could be, itself, a banking entity. Mr. Bronson noted that, because control is tested based on voting authority, not just beneficial ownership, a registered fund could be a banking entity if 25% or more of its outstanding securities are held through programs offered by banks or bank affiliates for the benefit of bank clients where the bank, or its affiliate, has voting authority over the securities. He explained that, given the motivations behind the Volker Rule, there is an open policy question about whether a fund should be considered a banking entity where a bank has voting authority over a large portion of the fund's securities, but may not have any beneficial ownership interest in the fund.

Mr. Kini described the types of transactions between covered funds and banking entity advisers or sponsors that are prohibited under Section 23A of the Federal Reserve Act, such as extending credit to the fund, providing the fund with a guarantee, or entering into derivative transactions that cause the banking entity to have credit exposure to the fund. He explained that transactions not prohibited by 23A must meet the market terms requirement under the statute, meaning that a banking entity might be barred from giving discounts (e.g., on advisory fees) to a fund it advises or sponsors.

*Impact.* Mr. Bronson discussed some of the potential implications of the Volcker Rule for non-banks. He explained that the statute provides that a non-bank SIFI, as designated by the FSOC, becomes subject to certain requirements under the Volcker Rule if the Federal Reserve adopts an additional regulation specifically for non-bank SIFIs.

Mr. Bronson said, in his view, there appears to be a consensus that the Volcker Rule has had an impact on the markets, although it is difficult to know the extent to which changes in the markets, particularly liquidity in the bond markets, are a result of the Volcker Rule as opposed to other developments, such as Basel III, increased focus on risk management, and expectations regarding potential changes to interest rates. Mr. Whetzel pointed out that there are as yet unknown, and likely unintended, consequences of the Volcker Rule, particularly in combination with Basel III and new market risk capital rules, which may become apparent if interest rates rise and sellers of fixed income securities outnumber buyers.

Ms. Massari discussed that the potential bifurcation of liquidity between U.S. and non-U.S. customers. Under propriety trading provisions, foreign banks generally are allowed to trade under the TOTUS exemption with non-U.S. customers subject to fewer compliance obligations and requirements. As a result, market participants could see foreign banks dividing market making activities between desks that can trade with U.S. customers and desks that cannot trade with U.S. customers. Mr. Kini also noted that investment activity by banks in the private fund and venture capital space likely will be restricted as a result of the Volcker Rule.

## General Session — OCIE and Enforcement: Same Old Wine in a Different Bottle, or a New Vintage?

*Moderator*: **Ari Gabinet**, General Counsel, OFI Global Asset Management, Inc.

*Speakers*: **Andrew J. Bowden**, Director, National Examination Program, U.S. Securities and Exchange Commission
**Andrew Ceresney**, Director, Division of Enforcement, U.S. Securities and Exchange Commission
**Mark Cahn**, Partner, Securities Department, Wilmer Cutler Pickering Hale and Dorr LLP

This panel discussed the current focus and structure of OCIE, recent developments and the use of big data, and trends in examinations and enforcement.

*OCIE's Focus and Structure.* Mr. Ceresney began by noting that OCIE is currently in a position where, instead of reacting to a particular crisis, as was the case in the early 2000s with accounting fraud and over the past five years with the financial crisis, it has the opportunity to step back and consider where its focus should be. He stated that OCIE is currently pursuing a wide variety of actions and is working to empower the examiners and enforcement officials on the front lines. He noted that the SEC as a whole has been supportive of OCIE's authority and that if OCIE makes a recommendation to the SEC on an enforcement action, the SEC will nearly always defer to that recommendation.

Mr. Ceresney lauded the specialized unit structure of the Division of Enforcement (the "Enforcement Division"), established by former Director Khuzami, which divides the Enforcement Division into five specialized units, each of which focuses on a particular area: asset management, market abuse, complex financial instruments, foreign corrupt practices, and municipal securities and public pensions. He noted that task forces are utilized to identify and "incubate" cases before they are handed off for investigation and expressed his belief that the specialized unit structure creates expertise within the Enforcement Division that was not there before.

Mr. Ceresney stated that the Enforcement Division's goal is to enforce laws in a way that is "aggressive and creative," but fair. The Enforcement Division is encouraging examiners to focus on areas that have not historically been the subject of focus, to utilize strict liability rules (e.g., failure to file annual financial statements), and to creatively apply rules (e.g., using Rule 38a-1 under the 1940 Act to pursue an individual that misled an adviser's Chief Compliance Officer ("CCO"); using Section 20(d) of the Securities Exchange Act of 1934 in connection with insider trading). The Enforcement Division is streamlining and consolidating cases by bringing multiple related cases at the same time and offering a settlement matrix that incentivizes quick acceptance of the settlement terms.

*Recent Developments and the Use of Big Data.* Mr. Bowden remarked on three recent changes affecting OCIE: (i) advances in the ability to analyze large data sets; (ii) the development of more industry experts at the SEC with whom OCIE can consult; and (iii) the establishment of a national governance structure with a uniform set of priorities, policies, and procedures across the various regional offices.

With respect the ability to analyze large data sets, Mr. Bowden noted that new technology allows the National Examination Program (the "Program") to use big data for (i) systematic analysis through the processing, for example, of ADVs and other adviser information to assign a risk rating that helps the Program determine who to examine and on what areas to focus; (ii) tactical analysis once a risk is identified; and (iii) field analysis to process large sets of quantitative data in an efficient manner by, for example, analyzing a firm's trade blotter from the past 3 years in the form in which the firm maintains it. Mr. Bowden stated that the examiners "try to be sensitive" to the burden on the industry when they think about what data to request. He explained that, while he has no philosophical objection to sharing the SEC's big data analysis tool with the industry, there are complications with doing so and he believes that if certain data is consistently requested during examinations, the industry will develop its own tools to test and check the data, thus promoting compliance.

Mr. Ceresney also expressed his enthusiasm for the developments in big data analysis, stating that the Enforcement Division was trying to use big data as much as possible for detection and facilitation of investigations. He noted that trading data can be analyzed to look for patterns of situations where traders are trading in unison, which signals possible insider trading. The Enforcement Division also uses big data to identify aberrational fund performance and quickly analyze account records and phone records.

*Trends in Examinations and Enforcement.* Mr. Bowden explained that a deficiency letter is not always a prelude to an enforcement case, reporting that about 80-85% of exams result in deficiency letters, but only about 10% of exams get referred to enforcement. Mr. Bowden stated that he tells examiners that they are the eyes and ears of the SEC and that their job is to engage with subject firms to help promote compliance. He stated that the OCIE works to avoid using the exam program to be de facto rule makers and that deficiency letter will either identify conduct that ties back to existing laws, rules, or regulations or identify material weaknesses in controls that may result in future problems if not rectified.

Mr. Bowden disagreed with Mr. Gabinet's noted perception that the staff and the industry are more polarized now than in the past, commenting that industry participants have always known that when the SEC conducts an exam, an enforcement action might result. He noted that when a firm "lawyers up" during exams, the examiners could view the firm as being obstructionist. He further stated that firms should not necessarily worry when lawyers from the enforcement group accompany examiners to an exam, as enforcement personnel sometimes attend exams because they are subject matter experts in the area that will be the focus of the exam and other times because they have volunteered to attend for their own training purposes.

Mr. Gabinet noted the recent trend of informal requests to firms via email asking for more information on a particular matter and of requests for narrative responses. Mr. Ceresney explained that informal communication may be pursued at the outset of an inquiry to determine whether there is something worth pursuing. Mr. Cahn stated that the staff would be hard pressed to point to legal authority for narrative requests, but the industry generally responds to these requests so as to avoid receiving a subpoena.

Mr. Bowden discussed the recent sweep on distributions payments, noting that distribution related fees are of interest to the SEC because distributors often have significant leverage, advisers may have conflicts of interest with respect to distribution, and it is not clear from expense tables and other disclosure where the money ends up at the end of the day. OCIE continues to examine distributors and advisers with respect to the use of 12b-1 fees, sub-transfer agency fees, and revenue sharing.

## General Session — Ethics

*Speaker*: **Michael D. Greenberg**, Director, Center for Corporate Ethics and Governance, RAND Corporation

*Introduction.* Mr. Greenberg discussed the importance of ethics in the business world, why some employees act unethically, how companies can limit the likelihood of unethical behavior, and how certain common practices or structures tend to lead to weak ethical cultures. Mr. Greenberg's remarks on ethics focused not on front-page illegal behavior, but rather on motivating people to do the right thing on the everyday matters that all employees face.

He discussed a number of reasons why corporate entities do not focus sufficiently on ethics, including because ethics is a soft or "touchy feely" subject and the success of efforts to instill an ethical culture can be difficult to quantify. Although he acknowledged that the monetary ramifications of a strong ethical culture can be hard to quantify (e.g., fines and compliance settlements avoided), he argued that the long-term reputational benefits of an ethical culture can be significant and tangible.

*Why Some Behave Unethically.* Mr. Greenberg reviewed the most common reasons employees behave unethically, including the presence of incentives that encourage unethical behavior, pressure from peers and superiors who behave unethically, a lack of understanding on how to behave ethically, a lack of controls to detect and deter bad behavior, a lack of a corporate culture of self-reflection, and fear of reprisals if unethical behavior is identified or reported internally. During the discussion that followed, Mr. Greenberg noted that these triggers of unethical behavior can be mitigated substantially through efforts such as establishing a culture of ethical behavior (i.e., tone from the top), creating a safe, reprisal-free method of internal reporting regarding ethical concerns, establishing controls to detect and deter bad behavior, and protecting whistleblowers. He also stressed the importance of educating all levels of employees at a company on compliance and ethics.

*The Problems of Hollow Compliance.* Mr. Greenberg discussed the importance of certain structural issues in establishing an ethical culture. Mr. Greenberg noted that a culture of compliance focused on doing the minimum that needs to be done to comply with the law will likely fail to address the core issue of motivating employees to do the right thing and avoid unethical behavior. As an example of hollow compliance models, he cited “check-the-box” questionnaires and cultures where compliance is reduced to a technical exercise of parsing rules or doing the minimum to be “safe.” He argued such cultures avoid the important work of inculcating a culture of reflection about doing the right thing.

Mr. Greenberg also discussed the importance of empowering those who perform the compliance function and the placement of the CCO in the corporate hierarchy. He noted the important signal sent to all employees if the CCO is buried in the corporate hierarchy below layers of management. He noted that Rule 38a-1 under the 1940 Act was designed to address that potential issue by mandating a direct reporting line from the CCO to the board of trustees of a fund, as well as an annual report from the CCO to the board regarding material compliance matters. He noted that the design of Rule 38a-1 ensured that the board would devote significant time and energy to compliance matters, again re-enforcing the message to the entire corporate community that the company values ethical behavior.

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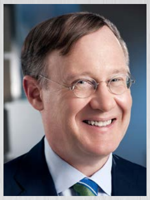

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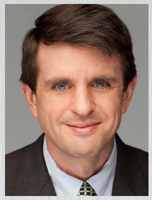

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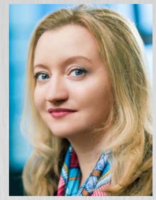

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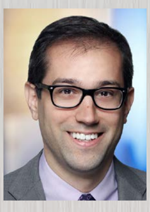

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