2017 ICI CONFERENCE

ICI Mutual Funds and Investment Management Conference Summary

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2017 ICI MUTUAL FUNDS AND INVESTMENT MANAGEMENT CONFERENCE

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GENERAL COUNSEL'S ADDRESS

Speaker: David W. Blass, General Counsel, Investment Company Institute (ICI)

Mr. Blass addressed the potential opportunities that may arise for the industry out of the recent change in the presidential administration, the ICI's priorities, and mission-critical regulatory initiatives for the industry.

Mr. Blass commented on the high degree of alignment between the stated goals of President Trump's administration for regulation and regulatory change and those of the industry, including empowering Americans to make informed and independent financial decisions, administering efficient, effective and tailored regulations, and fostering economic growth and vibrant financial markets. Mr. Blass stated that those priorities should lead to greater entrepreneurship and ownership, growth, efficient capital allocation and diversity in financing sources.

Mr. Blass observed that the significant new regulations affecting the mutual fund industry, including enhanced data reporting, liquidity risk management and optional swing pricing, have required and will continue to require significant resources. He commented on how those burdensome regulatory initiatives come on the heels of money market reform, the Department of Labor's (DOL) amended definition of "fiduciary" and related rules (collectively, the fiduciary rule) and the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), including the Volcker Rule. He illustrated the avalanche of regulatory change by noting that the ICI had submitted 111 comment letters over the past year. He said the ICI will be focused on seeking the space and time to implement what has been adopted and will focus on working with regulators on aspects of those reforms that may be unnecessarily burdensome and complex. As examples of opportunities for regulatory improvement or clarification from the U.S. Securities and Exchange Commission (SEC), he noted aspects of the liquidity rule relating to the classification of assets and the treatment of exchange-traded funds (ETFs) that redeem in kind. He also stated that the ICI would be focused on the role of directors and trustees of mutual funds and ETFs and the potential to avoid duplication between their functions and those of Chief Compliance Officers (CCO) and other staff.

Mr. Blass then reported on the ICI's mission-critical regulatory initiatives. He commented on the ICI's intention to focus on shortening the settlement cycle from T+3 to T+2; a uniform fiduciary standard for advisers and broker-dealers, which could be promulgated by the SEC or Financial Industry Regulatory Authority (FINRA); a more focused rule on mutual funds' use of derivatives that would not apply the proposed portfolio limits and would employ a more targeted approach to asset segregation requirements; and electronic delivery of shareholder reports. Mr. Blass noted the importance of FINRA rationalizing the fee rates charged to funds by intermediaries for delivery of shareholder reports, and ultimately borne by fund shareholders.

Mr. Blass then commented on an industry challenge on the horizon. He summarized reports that argue there may be antitrust issues associated with funds in a fund complex holding ownership positions in companies competing in the same industry. He stated that the reports suggest that such ownership positions may cause management of those companies to not compete as strongly with each other on price. Mr. Blass argued that such assertion seems to significantly overstate the influence that minority owners can have on management and a company's business practices, assumes that managers across a sin-

gle complex will have a monolithic view on the investment and how a company should operate, and mistakes correlation with causation. With respect to the final point, Mr. Blass noted that the assertion that rising prices in certain industries were caused by common ownership ignores the effect of other dynamic market factors, such as increasing demand. Mr. Blass stated that although the views stated in the reports appear misguided it is important to combat such ideas before they become part of common wisdom or begin to inform policy positions. He noted the ideas in the reports appear to be gaining some traction with some European regulators. He also noted that limits on a fund complex's investments in competitors in a single industry would have dire effects on index investing and the ability to provide diversified portfolios for investors.

KEYNOTE REMARKS

Speaker: David W. Grim, Director, Division of Investment Management, U.S. Securities and Exchange Commission

Mr. Grim commented on the Division of Investment Management's priorities, including continuing to look for industry trends that give rise to regulatory concern, and focusing on providing guidance to the industry through IM Guidance alerts and responses to frequently asked questions (FAQs). He referred to the Staff's recent guidance on robo-advisers, advisor custody and issues associated with implementation of the DOL's fiduciary rule.

Mr. Grim then commented on potential priorities for Mr. Clayton if he is confirmed. He stated that the hiring freeze order applies to the SEC, while certain other orders do not, but that the staff will still look to such orders for principles that should apply to the staff's work. He stated that the staff will continue to think about the greater use of electronic delivery, the proposed derivatives rule, third-party examinations of investment advisers, disclosure effectiveness and regulations applicable to ETFs. During the discussion that followed, Mr. Grim said that the Staff was open to discussions on the burdens on trustees and directors and the possibility that some of those responsibilities might be delegated to CCOs. He said the staff was also open to listening to instances of unintended consequences associated with the implementation of the liquidity rule and enhanced data reporting. He also said that the staff was also considering whether a summary approach to disclosure, as illustrated by the summary prospectus, would be useful and effective in other areas, as well as the potential benefits of the greater incorporation of technology in communications with investors. In that respect, Mr. Grim encouraged the industry to communicate its perspectives on these matters with the Staff. Mr. Grim referred to the implementation of money market reform as a template for industry and the Staff communicating on areas of regulation that required clarification in the form of responses to FAQs. Mr. Grim also commented on the disclosure branch's focus on smart beta funds, commenting in a manner intended to result in relevant disclosures that are accurate and clear and, where possible, simple.

GENERAL SESSION

The Changing Legislative and Regulatory Landscape—What to Expect

Moderator: Heidi Stam, Former Managing Director and General Counsel, Vanguard

Speakers: Barry P. Barbash, Partner, Willkie Farr & Gallagher

Joseph J. Barry, Senior Vice President, Industry Affairs, State Street

Troy A. Paredes, Founder, Paredes Strategies

Dawn Vroegop, Chairperson, MetLife Funds

This panel discussed the implications for the regulated fund industry and fund shareholders of changes in legislative and regulatory priorities under the Trump administration. Mr. Paredes said that he was optimistic for economic growth, the markets and investors, stating his view that policies favoring capital formation implied investor protection as a necessary corollary. Mr. Barry said that the Obama administration had been locked into a post-crisis mentality, and that it was now time for a new administration to look forward. He said that it would be difficult to change the Dodd-Frank Act even if the administration wanted to, but that the administration could affect the implementation of revenue-related elements of the Dodd-Frank Act. Mr. Barbash agreed that any changes to the Dodd-Frank Act would be slow and incremental, and predicted that the derivatives trading regulations would remain in place. Ms. Vroegop said that investment company boards would welcome better-tailored regulations, observing that many recent regulations (such as those addressing money market reform, liquidity, and business continuity) imposed duties on boards that risked diverting attention from oversight of investment advisers and conflicts of interest.

Mr. Paredes predicted that the proposed Financial CHOICE Act[1], an effort to roll back parts of the Dodd-Frank Act, was likely to pass the House, but that its fate in the Senate was unclear. He said that the best opportunities for change were non-regulatory, such as through FAQs, rules, exemptive relief, no-action letters, enforcement priorities, and through the Office of Compliance Inspection and Examinations (OCIE) favoring "educational" deficiency letters over enforcement referrals. The panelists were in agreement that the Trump administration is unlikely to designate any entity a systemically important financial institution (SIFI); however, Mr. Barry noted that it remained important to address issues with the Financial Stability Oversight Council (FSOC) to ensure that the SEC remained the primary regulator for the fund industry.

Mr. Barry predicted that Jay Clayton would be confirmed as Chairman of the SEC by Easter, but that it may be months beyond that before other Commissioners were confirmed. Mr. Barbash noted the importance of appointing SEC Division Directors in the meantime. Mr. Paredes said that he expects the SEC under Mr. Clayton to emphasize capital formation as a goal, and that he did not consider this to be at odds

[1] The key principles as stated in the Executive Summary are: economic growth must be revitalized through competitive, transparent, and innovative capital markets; every American, regardless of circumstance, must have the opportunity to achieve financial independence; consumers must be protected from fraud and deception as well as the loss of economic liberty; taxpayer bailouts of financial institutions must end and no company can remain too big to fail; systemic risk must be managed in a market with profit and loss; simplicity must replace complexity, because complexity can be gamed by the well-connected and abused by the Washington powerful; and both Wall Street and Washington must be held accountable.

with investor protection. Mr. Barbash said that the SEC rulemaking agenda would reflect the Trump administration's big picture themes, such as less regulation and an emphasis on capital formation. As an example, he said that money market reform passed with these themes in mind could have favored capital formation. Mr. Paredes said that he expected a rigorous cost-benefit analysis to inform SEC rulemaking, and also advocated a retrospective cost-benefit analysis of existing rules to assess their effectiveness. Mr. Barbash cautioned against over-reliance on cost-benefit analyses, stating that he believed such over-reliance could result in the loss of broader perspective. Ms. Vroegop said that cost-benefit analysis was particularly important in assessing the impact of regulation on smaller and mid-sized investment advisers. She also recommended that the SEC allow boards to delegate fully day-to-day responsibility for valuation.

Turning to international matters, Mr. Barry said that it was not clear how committed the Trump administration is to international organizations, but that it would be good to have some global leadership allowing U.S. banks to operate worldwide on U.S. standards and, if international standards instead were established, that U.S. standards should align with those standards. As an example, Mr. Barbash noted that the treatment of soft dollars in the U.S. and Europe was not in sync, which introduced operational complexities for firms operating globally.

Looking to the future, Mr. Paredes said that, while it was not clear how Mr. Clayton would view the SEC's enforcement role, he did not expect a pullback in overall enforcement efforts, although it was possible that the "broken windows" approach would be scaled back, allowing more resources to be applied to more serious matters. Mr. Barbash said that there would be continued enforcement focus on the asset management industry because "that's where the money is." He said that OCIE was originally designed to be an educational mechanism for the industry, but that this role had been diminished under the enforcement-oriented, broken windows philosophy. He said he hoped that OCIE would become more cooperative and educational in the future.

The panel concluded with thoughts on a range of questions posed by Ms. Stam. Regarding enforcement settlement costs, Ms. Vroegop said that was not fair that bad acts by individuals resulted in corporate penalties that ultimately harmed investors, including mutual fund shareholders, but Mr. Barbash noted that, from the SEC's perspective, it was hard to get quick successes by going after individuals, because the individuals fight back hard, resulting in degraded enforcement statistics. Mr. Barry said that there may be some movement in Congress to reduce the regulatory burden on issuers, including through a rethinking of some aspects of Sarbanes-Oxley. Mr. Barbash said that the emphasis on capital formation may result in a focus on business development companies and on restrictions on what investment companies may purchase. Finally, the panelists predicted that there may be (i) a rule addressing ETFs, (ii) a review of how 401(k) accounts are invested, (iii) a movement towards "Rothification" of retirement accounts so that all accounts are funded with after-tax earnings, and (iv) a potential re-evaluation of existing SEC rules, but perhaps not a fiduciary standard equally applicable to investment advisers and broker dealers.

SESSION 1-A

Inside the Boardroom: A Roundtable Discussion

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

Speakers: Marguerite C. Bateman, Partner, Schiff Hardin LLP

Patricia Louie, Executive Vice President and General Counsel, AXA Equitable Funds Management Group, LLC

Philip H. Newman, Partner, Goodwin Procter LLP

Has Fund Board Composition Changed as Board Responsibilities Have Increased? Ms. Lancellotta opened the session by reviewing developments in investment company governance over the past quarter century, highlighting (i) the 1992 SEC Staff Report, "*Protecting Investors: A Half Century of Investment Company Regulation*" (which, she noted, proposed a number of regulatory changes relating to fund governance, most of which were not adopted), (ii) the 1999 ICI Best Practices report, (iii) SEC fund governance rules adopted in 2001 and 2004 and (iv) the SEC's compliance program (rule 38a-1), which increased fund boards' formal responsibilities with respect to compliance matters.

The panel discussed the tendency of many fund boards to seek new board members who have very specialized experience relevant to certain topics that have come to require more board attention (such as derivatives, liquidity, cybersecurity, distribution practices and subadviser oversight). Mr. Newman noted the risks that, if boards are composed increasingly of technical experts (1) they may be tempted to act more as managers than as overseers and (2) other board members will defer to the views of board members who are perceived to be experts with respect to particular topics. Ms. Louie noted that the judge in the recent AXA mutual fund fee litigation noted, apparently with disapproval, that the AXA fund board did not include any members who were former regulators. Ms. Lancellotta said that the SEC should take care not to assign to fund boards any responsibilities that only a technical expert would be capable of discharging. She observed that the SEC's proposed derivatives rule, and the original version of the new liquidity rule, threatened to cross this line.

How Fund Boards Cope with the Increased Complexity of Their Role. The panel discussed a variety of approaches for keeping fund boards informed regarding the evolution of the adviser's business and the changing competitive landscape. It was noted that periodic presentations to the fund board by the adviser's senior management regarding these matters is now typical.

Mr. Newman cited ICI/IDC survey data indicating that boards have tended not to increase the number of meetings they hold, but instead to increase the length of their meetings and to rely more and more on board committees to conduct a substantial part of the board's functions. Ms. Louie noted that many boards have formed a number of separate subcommittees focused on investment matters and that these committees can meet concurrently to review the portfolio activities of different funds in the fund group. Ms. Bateman said that, if a board relies heavily on committees, it is important to have an effective means of communicating to the full board the substance of each committee's activities, so that all board members are appropriately informed of matters dealt with at the committee level. Practices that help promote board understanding of the work of committees include (1) periodic rotation of members among the different committees and (2) making every committee's meeting materials available to all board members as a matter of course.

Mr. Newman noted the importance of a substantive "onboarding" process to introduce new board members to the fund group and the work of the board. He said that informational sessions designed for new board members can also serve as good "refreshers" for existing board members. He also observed that some boards appoint an experienced board member to serve as a mentor for each incoming new member.

Mr. Newman said that communication among board members in advance of scheduled meetings can help identify matters on which the board wishes to focus its attention during the meeting. Ms. Bateman noted the value of putting the most significant issues that will be considered at the meeting first on the meeting agenda. Ms. Bateman noted the utility of having each committee chair contact each committee member in advance of committee meetings to elicit members' views and comments regarding matters on the meeting agenda.

Mr. Newman said that independent board chairs are increasingly involved in helping determine how much meeting time will be allocated to each item on the meeting agenda. Ms. Bateman cautioned that management should not treat the independent chair as the sole voice of the independent board members, and should not assume that the chair is necessarily empowered to speak for all the independent board members on all matters.

Ms. Louie commented regarding the importance of a good working relationship between management and the independent directors' counsel.

Mr. Newman offered the observation that fund boards have limited ability to bring about change at a fund group. Their principal role, he said, is to engage in a dialogue with management regarding issues that are of critical importance to fund shareholders.

Mr. Newman commented regarding different views as to the role of the CCO of a fund group. Some boards, he said, view the CCO simply as the administrator of the funds' compliance program, others look to the CCO to be a strategic thinker regarding compliance matters, and some others see the CCO as an independent reviewer of compliance functions that are conducted primarily by other units within the organization.

Innovations in Board Practices. The panel discussed the utility of fund board site visits to subadvisers and other third-party service providers. Panelists expressed the view that board site visits to subadvisers' offices can be useful, but suggested that boards should view these visits as observational opportunities, rather than as occasions for the board to intervene in the adviser's performance of its role of selecting and overseeing subadvisers.

With respect to electronic board books, Ms. Lancellotta observed that there is a tendency for board materials to become more voluminous if provided in electronic format. Regarding the general tendency of board materials to become more extensive as the board's oversight responsibilities increase, Mr. Newman noted the value of executive summaries of important topics, and of the use of dashboard-style presentations that provide a concise pictorial summary of key data. Ms. Louie said that her firm's board materials are divided into two volumes, one containing more summary materials and the other containing supplemental materials that board members may wish to consult in their discretion. Ms. Bateman noted that many boards rely on "exception reporting" as a means of highlighting matters that might merit closer board attention. Mr. Newman cautioned that if a board chooses to rely on exception reporting, it should understand the standards and processes that are employed in identifying the matters that are reported as exceptions.

Recent Litigation. The panel discussed the recent AXA decision, noting that the court in that case looked not only at the board's annual contract renewal process, but also more broadly at the board's governance and oversight practices (including the process for selecting new board members, the process for setting board compensation and the board's educational sessions with outside presenters). Mr. Newman observed that the documentary record of the board's contract review process is extremely important evidence in shareholder suits challenging the level of advisory fees.

Ms. Bateman summarized a recent court decision in the PIMCO excessive fee litigation, *Kenny v. Pac. Inv. Mgmt. Co. LLC.*, noting that the court had held that the attorney-client privilege did not entitle a fund's independent trustees to withhold from the plaintiff shareholders communications between the independent trustees and their outside counsel. She cautioned against the use of email for the discussion of highly sensitive matters. She also stated that merely labeling a communication "attorney-client privileged" does not, by itself, establish that the communication is, in fact, privileged; the privilege applies only to confidential communications between a lawyer and his or her client in which legal advice is either sought or delivered. She further noted that sharing a communication between lawyer and client with any third party will typically extinguish the privilege with respect to that communication.

Desired Regulatory Changes Regarding the Role of Fund Boards. The session concluded with an opportunity for each panel member to identify regulatory changes regarding the role of fund boards that he or she thinks would be desirable. Ms. Lancellotta noted that the Independent Directors Council (IDC) intends to approach the SEC staff in the relatively near future to initiate a dialogue regarding steps that could be taken to eliminate board functions that are not especially useful, in order to allow boards to focus on the matters where they can make the most valuable contribution.

Ms. Bateman recommended that boards be relieved of the obligation to make quarterly compliance determinations regarding routine portfolio transactions between funds and their affiliates.

Ms. Louie suggested that fund boards be relieved of the responsibility for "fair value" determinations of assets for which market quotations are not readily available.

Mr. Newman proposed that boards be relieved of the burden of policing payments to intermediaries as possible payments for "distribution in guise," suggesting that the SEC make the recipients of the payments rather than the fund board accountable for compliance in this regard.

Ms. Louie said that fund boards should be relieved of the obligation to approve fidelity board coverage, and that SEC should address the now largely obsolete list (issued at the time of adoption of Rule 12b-1) of factors that boards should consider when approving Rule 12b-1 lans.

The panel concluded with a discussion as to whether it would be desirable to eliminate the requirement that certain fund board approvals occur at a meeting held in person. Panelists disagreed on this question.

SESSION 1-B

A Changing Global Environment: The New Political Landscape and the International Outlook

Moderator: Gregory P. Dulski, Senior Corporate Counsel, Federated Investors

Speakers: Lucinda Creighton, Chief Executive Officer, Vulcan Consulting

Sara P. Crovitz, Deputy Chief Counsel, Chief Counsel's Office, Division of Investment Management, U.S. Securities and Exchange Commission

Paul J. Elmlinger, Deputy General Counsel, Franklin Templeton Investments

The panel addressed international developments and regulatory initiatives as they impact global asset managers, focusing on U.S. managers with significant operations and sales efforts in the European Union (EU) and United Kingdom (UK).

SEC's Interaction with Non-U.S. Regulators. Ms. Crovitz described ways in which the SEC coordinates with non-U.S. regulators. The SEC participates regularly in groups such as the International Organization of Securities Commissions (IOSCO) and the Financial Stability Board (FSB). European regulators had consulted with the SEC in connection with preparing the MiFID regulations and AIFMD passporting rules. In addition, the SEC had actively engaged with individual European governments in connection with reclaims of withholding tax payments on dividends received by non-EU institutional investors. She described a final report by the FSB on structural vulnerabilities in the asset management industry that directed IOSCO to operationalize and implement its recommendations on liquidity and leverage. While this process of addressing structural vulnerabilities is ongoing, there will be a pause in any efforts to designate non-bank global "systemically important financial institutions" (G-SIFIs).

EU Politics and Brexit. Ms. Creighton highlighted the fragile political condition of the EU at present, and commented on what she perceives as a disproportionately London-centric emphasis by U.S. firms when they consider developments in Europe. While an upcoming Dutch vote would not likely be dramatic, elections later in the year in France could have a significant destabilizing effect. Brexit raises the prospect of a new Scottish independence referendum, and any significant delays in implementing changes to Brexit could place massive pressure on the UK to negotiate a full array of trade agreements in a very short time.

Implications of Brexit for U.S. Managers with London Offices. Mr. Elmlinger described several implications for U.S. managers that rely on their London-based personnel to access European clients and markets, focusing on key buzzwords (1) equivalence, (2) delegation, and (3) substance. He said that the practical downsides would not be dramatic if the EU determines that the UK regulatory regime is "equivalent" to the European regime. He stated that "delegation" requires a licensed management company in the EU that can delegate portfolio management discretion to a UK-based manager, provided there are appropriate cooperation arrangements in place between the regulators in the UK and the relevant EU jurisdiction. Where there is a delegation of portfolio management by an EU-based management company, the "substance" requirements dictate that the manager have adequate substance on the ground in the relevant EU member state. He predicted that the substance requirements will be a focus of regulators seeking to prevent jurisdictional arbitrage, noting that the European Securities and Markets Authority (ESMA) is currently undertaking a study of the application of substance requirements.

U.S. Trade Agreement Process. Ms. Crovitz described how the Treasury Department and U.S. trade

representatives generally take the lead on negotiating trade agreements with other countries. She noted that the SEC works in parallel to develop memoranda of understanding with non-U.S. regulators in order to coordinate the implementation and enforcement of rulemaking and policy initiatives.

Managing Uncertainty and the Future of Globalization. Turning to broader themes, Mr. Elmlinger commented that the current political uncertainty presents both challenge and opportunity for U.S. regulators, which could lead either to greater protectionism and withdrawal by the U.S. or to continued international engagement. He noted that the ultimate selections to fill several important U.S. policy positions in the Trump administration could have a significant impact on the positions taken. Citing the recent logistical difficulties of coordinating derivatives clearing rules across jurisdictions, he predicted that the U.S. would remain involved enough in the FSB to avoid any G-SIFI designations for U.S. companies. Ms. Crovitz observed that the Financial CHOICE Act could impede U.S. financial regulators' ability to participate in international working groups. Turning to the UK/EU, Mr. Dulski said he expects a significant period of time to be required following Brexit in order to dig through the mounds of regulation that will have to be implemented by the UK, and Ms. Creighton commented that the UK's Great Repeal Bill, which will have the effect of repealing or adopting all EU law in the UK, might alternatively be referred to as the "great transposition act" given that it effectively transposes large swaths of EU regulation wholesale into UK law.

Soft Dollars and Equivalency. During a question period, the panel discussed the complications for global firms arising out of the treatment of soft dollars (or soft commissions) as potential "inducements" under EU regulation. Noting that these EU rules would potentially require asset managers to unbundle payments for trading and payments for research, Mr. Elmlinger observed that specific payments for research might not fall under the Section 28(e) safe harbor for soft dollars, raising the possibility that the adviser could fall within the technical definition of a broker or dealer and, therefore, be subject to a dual registration requirement. Ms. Crovitz stated that requiring dual registration would impose "huge cost" and that the SEC staff would require a "principles-based way to give relief" to advisers that would potentially fall within the broker-dealer definition solely because they disaggregate trades in response to EU anti-inducement regulations.

Challenges Facing the Industry Globally. The panelists closed by discussing their views of the biggest challenges facing the global fund industry. Mr. Elmlinger cited to fee and cost pressures as a paramount challenge, and also singled out the inherent incongruities of expanding prudential regulation to the asset management industry. Much like the saying about the Holy Roman Empire, he concluded, prudential regulation is neither prudential nor regulation.

SESSION 2-A

The Evolution of Investing: Opportunities and Challenges in the ETF Marketplace

Moderator: Jane G. Heinrichs, Associate General Counsel, Securities Regulation, Investment Company Institute

Speakers: Gregory A. Friedman, Head of ETF Services, Fidelity Investments

Allison Fumai, Partner, Dechert LLP

Jasmin Sethi, Vice President, BlackRock, Inc.

The panel focused on current issues in the ETF space.

ETF Product Trends. The panel began with a discussion of four significant trends and their impact on ETFs: (i) active-versus-passive investing, (ii) smart beta, (iii) robo-advisers, and (iv) non-transparent ETFs. The panelists first noted that the active versus passive debate has been raging for years, and added that passive has been doing well relative to active in recent years in terms of new flows, but that the trend is primed for a reversal. It was noted that many firms are banking on active management as a differentiator in the ETF space. With respect to smart beta or "factor" products, the panel noted that there has been a proliferation of such products, especially since the definition of "smart beta" is open to interpretation. The panelists pointed out that the SEC staff has been scrutinizing smart beta offerings recently by focusing on whether a smart beta ETF's index methodology is truly rules-based, noting that the staff has been requesting index "rule books" and requiring additional disclosure of index methodologies. The panel discussed robo-advisers and asset allocation model portfolios, noting that ETFs fit very well in those programs due to their low cost, relative tax efficiency and wide range of exposures. The panel described two basic "non-transparent" active ETF structures – the blind trust model and the proxy or hedge basket model. Noting that neither structure had been approved by the SEC, Ms. Fumai highlighted some of the features of each model. The blind trust model involves in-kind creation and redemption transactions made through a blind trust that shields the ETF portfolio, with authorized participants (APs) and market makers receiving an enhanced "INAV" (or indicative NAV) throughout the trading day to enable them to hedge their exposures and to engage in arbitrage activities. In contrast, the proxy basket or hedge basket model would utilize an optimized creation/redemption basket that would closely mirror the exposures of the ETF portfolio without disclosing details of the portfolio. This model would utilize INAV to transmit indicative pricing information to APs and market makers during the trading day. Certain of these structures have been in front of the SEC for over 10 years without approval, largely because the SEC staff remains unconvinced that APs and market makers will have enough information for the ETF arbitrage mechanism to function effectively. Ms. Fumai also described the exchange-traded mutual fund (ETMF) structure, noting that the market price of the ETMF shares is pegged to the end-of-day NAV. She added that a number of ETMFs had been launched, but it is too early to determine whether the products will be successful.

Opportunities and Challenges for ETFs. The panel discussed the U.S. ETF market and some of the challenges and opportunities that sponsors will face. Mr. Friedman noted that "dipping your toe into the market" has not proven effective, even for large asset managers. Instead, he suggested that new entrants need to have a clear approach and a differentiating narrative. Will the ETFs be clones of existing mutual fund products? Are you merely offering the same product at a lower price because the ETF

structure is preferable to investors? Will ETFs function as building blocks in the sponsor's broader product lineup or will the ETFs be complimentary to the existing product set? The panelists agreed that effective distribution is the key to ETF success, and noted that building successful distribution requires sales force training, alignment of compensation and incentives with other products and patience. The panel also talked about the need for ETF sponsors to build a real ETF team with expertise in a variety of critical areas, including navigating the legal and regulatory landscape, effective engagement with APs and market makers through an experienced, dedicated capital markets team, and a product team that understands the existing ETF market and opportunities for differentiating the offering. The panel discussed the unique legal and regulatory issues ETFs face, including the exemptive order process and the potential need for Rule 19b-4 relief to list an ETF's shares. In addition, the panel discussed recently adopted exchange rules requiring ETFs to continuously meet the exchange's initial listing standards.

Distribution. The panel discussed the potential for ETFs to be included on 401(k) platforms. It was agreed that while 401(k) platforms do not currently have the technology to allow participants to trade ETFs, the technology would likely be developed in the future. The panel also discussed creation and redemption basket issues and their potential to hamper newer ETF market entrants as early ETF sponsors have more flexibility to construct efficient in-kind baskets that contribute to tax efficiency and superior index tracking.

Liquidity Rule. The panel touched on the recently adopted liquidity rule which goes into effect in 2018, noting that ETFs had to consider the impact of liquidity determinations on the arbitrage mechanism and on basket construction practices. The panel also discussed the exception from the rule for in-kind ETFs, including what it means to be an in-kind ETF and what a "de minimis" amount of cash might be, as the SEC did not articulate a clear standard in the adopting release. The panel discussed research that the ICI had performed regarding the number of ETFs that might meet the in-kind definition. There was consensus that additional SEC guidance would be helpful to the industry in making a determination as to what constitutes a "de minimis" amount of cash.

Fund Reporting Rules. The panel discussed the impact of the recently adopted fund reporting rules on ETFs. Areas discussed included the designation of funds as "in-kind" ETFs, disclosure of creation and redemption activity by APs, as well as information on securities held as collateral in connection with such activity, and information about transaction fees collected by ETFs. The panel also noted that the SEC staff appears to be particularly concerned about what happens when an important AP ceases to facilitate creations and redemptions.

Areas of Regulatory Focus. The panel discussed the likely areas of regulatory focus in the coming year, including (i) compliance with exemptive order conditions and exchange listing rules, (ii) disclosure of strategies in registration statements and on websites, (iii) the mechanics of the creation and redemption process and the effectiveness of the arbitrage mechanism and (iv) secondary market trading and related market structure issues. The panelists predicted that there would be increased focus on the roles of APs and market makers in the secondary market, especially with respect to trading in fixed-income ETFs and underlying fixed-income securities.

SESSION 2-B

Mutual Fund Civil Litigation: Year in Review

Moderator: Julia S. Ulstrup, Moderator, Vice President and General Counsel, ICI Mutual Insurance Company, RRG

Speakers: Jeremy P. Blumenfeld, Partner, Morgan Lewis & Bockius LLP

Roberta R. Kameda, General Counsel, Dodge & Cox

Sean M. Murphy, Partner Milbank, Tweed, Hadley & McCloy LLP

The panel focused on three key areas of fund-related litigation (i) fee litigation under Section 36(b) of the 1940 Act, (ii) attorney-client privilege and the fiduciary exception and (iii) "proprietary funds" litigation under ERISA.

Fee Litigation under Section 36(b) of the 1940 Act. Mr. Murphy provided an overview of lawsuits following *Jones v. Harris Associates*, noting that there have been 27 cases filed over the last five years, including three cases filed since March 2016 (and 17 cases that are still pending). In these cases, plaintiffs have advanced two principal theories: (i) in the "manager of managers" lawsuits, plaintiffs have alleged that the adviser delegated substantially all of its management and administrative responsibilities to sub-advisers, yet retained a substantial portion of the fees, and (ii) in the "reverse manager of managers" lawsuits, plaintiffs have alleged that a manager's fee in respect of the manager's proprietary fund is excessive because that fee is substantially higher than the fee that the manager charges as a sub-adviser to other fund complexes. Mr. Murphy also explained that the plaintiffs' approach to "manager of managers" cases has changed recently insofar as plaintiffs have become more accepting of a manager's cost allocation methodology and have begun to focus instead on challenging a manager's profitability. In other words, plaintiffs have begun to allege that the manager is earning more money than is consistent with the manager's fiduciary duty.

Ms. Ulstrup explained that, over the past year, there have been several positive developments for advisers with regard to Section 36(b) litigation. The advisers prevailed in each of the two trials during the last 12 months, and, in various other cases, there were summary judgment decisions in favor of the advisers based on one or more of the *Gartenberg* factors. Mr. Murphy noted that, in a manager of managers case, plaintiffs may be facing an uphill battle, as "there are now two decisions that, at their core, reject the plaintiffs' main theory." Of course, he noted, a judge could, in the future, decide differently. But at this time, there have been nine trials, and no plaintiff has ever won a case brought under Section 36(b). And indeed, Mr. Murphy noted, there have been no filings since the AXA decision in August 2016—the longest stretch of time without a filing in the last five years—a fact that may indicate that plaintiffs are more hesitant to file Section 36(b) cases, and that 2017 and beyond may bring a significant slowdown in the filing of these cases. Furthermore, recent decisions in favor of the advisers may lower plaintiffs' settlement expectations.

In spite of this impressive string of victories, Ms. Kameda advised that it is important for managers to stay ahead of these issues. For example, Ms. Kameda's team routinely consults with litigation counsel to hear about lessons learned from recent decisions, new theories being tested by plaintiffs and which plaintiff evidence seemed to resonate with a judge or jury. Another practice Ms. Kameda suggested is reviewing and cataloguing for the board of directors any improvements in IT, research and trading, operations, shareholder communications, headcount, expense

ratios, and anything else that benefits the fund. Building a narrative, she advised, can be helpful to the manager should the need for it arise. Indeed, Mr. Murphy advised that, while a manager cannot avoid being sued, the best thing a manager can do is to review its 15(c) materials to ensure that its processes are robust and the information given to the board is comprehensive. In fact, Mr. Murphy noted that in two of the recent cases in which managers were granted summary judgment, the court granted summary judgment, in part, based on good board materials and processes.

Attorney-Client Privilege and the Fiduciary Exception. Ms. Ulstrup noted that plaintiff shareholders recently have attempted to invoke the "fiduciary exception" to compel production of privileged communications between independent trustees and their counsel. While these privileged documents generally would not be expected to be discoverable, plaintiffs have argued that the independent trustees owe shareholders a fiduciary duty and consult counsel in furtherance of that fiduciary duty, and thus the documents should be discoverable. Mr. Blumenfeld, discussing the "chilling effect" that these "fiduciary exception" cases have on communications between independent trustees and their counsel, discussed a recent Section 36(b) case, *Kenny*, in which a judge, relying exclusively on the fiduciary exception, compelled the production of privileged communications between the independent trustees and their counsel. Among all of the recent positive developments in the Section 36(b) space, Mr. Blumenfeld characterized the *Kenny* case as a "stand-out that went the other way." Mr. Blumenfeld added, however, that in a more recent case—a case that was decided during the last several weeks—a judge without elaboration or mention of the "fiduciary exception," denied a similar motion on the basis that the documents were privileged.

Ms. Kameda advised that, while it is difficult to provide concrete advice on how to address concerns arising from the invocation of the fiduciary exception in Section 36(b) cases, it is important to remember that something that is expected to be privileged—even if it is labeled "privileged"—is not always privileged. Specifically, Ms. Kameda suggested raising awareness about attorney-client privilege and the "fiduciary exception" both with internal legal staff and with company executives and trustees. Reminding them to think before putting anything in writing and encouraging independent directors to consult orally with counsel are critical steps.

Attorney-client privilege and the fiduciary exception is an area, Mr. Blumenfeld noted, that should continue to be watched very carefully.

Proprietary Funds Litigation Under ERISA. Ms. Ulstrup noted that, during the last several years, there have been class actions brought against plan sponsors and/or members of a plan's investment committee on behalf of plan participants, alleging that the plan participants would have been better served if the investment options for the plan had consisted of non-proprietary funds that were less expensive, and/or yielded better performance, than the proprietary funds that were in fact offered. Mr. Blumenfeld noted that the focus of these allegations has been that the plan sponsor offered proprietary funds to benefit the fund manager and its affiliates rather than funds that would have benefited the plan participants. Ms. Kameda advised that this, too, is an area that should be watched closely, and that firms should consult with ERISA counsel to learn about the specifics of recent cases. Ms. Kameda added that it is advisable for firms to maintain robust documentation supporting their investment option selections and may also wish to revisit their form of severance agreement to determine whether the agreement's release language

should be altered to restrict former employees from bringing lawsuits alleging breaches of fiduciary duty.

SESSION 3-A

Classified Assets: Translating the New Liquidity Rules into Firm Policies

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

Speakers: Paul G. Cellupica, Managing Director and General Counsel, Securities Law, TIAA

Jerry Cubbin, Senior Vice President, Director of Fixed Income and Alternatives Risk, OppenheimerFunds

Nancy M. Morris, Managing Director and Chief Compliance Officer, Wellington Management Company LLP

The panel began by discussing a number of broad points regarding the Liquidity Rule. In general, panelists felt that the Rule's adopting release did not provide especially helpful guidance as to compliance with the Rule, and suggested that the SEC staff might usefully publish an FAQ. They expressed the view that the Rule's provisions allowing funds to determine liquidity generally on the basis of asset class is a helpful development, although it will not necessarily be easy to apply.

Panelists discussed the likely location within their firms of principal responsibility for day-to-day compliance. Views diverged, with one panelist saying that the compliance function would likely be located principally among operations personnel, and another saying that it would likely be centered in a subcommittee of the firm's risk management committee. The panelists agreed that it would likely be preferable that a committee or group of persons be charged with rule compliance, rather than a single individual, since the process would likely benefit from more input, and that it would likely be desirable to receive input from risk, compliance, and trading personnel.

The panel noted that a number of third-party service providers are developing programs and products to assist fund groups in complying with the Liquidity Rule. One panelist noted that his fund group expects to send sample portfolios to a number of those third-party providers to test their products. Panelists agreed that use of third-party service providers would not limit a fund's obligations to ensure that the process is being conducted appropriately.

Panelists noted that the role of sub-advisers in the liquidity determination process is one of the most challenging aspects of the Rule. Panelists noted that a fund's portfolio manager may be in the best position to provide useful color as to a security's liquidity, but a portfolio manager at a fund's sub-adviser will not necessarily have much insight as to expected levels of redemptions, or as to the institutional ownership of the fund. Panelists said that, at a minimum, the process would require frequent and detailed communication between a fund's adviser and sub-adviser. They also noted the logistical difficulties of potentially maintaining and monitoring different liquidity determinations for the same security for different sub-advisory clients.

Panelists noted that the liquidity classification of a security can vary across different funds in the same complex, that liquidity is not a function of the security alone, but also of context. Panelists agreed that it is important not that a security's liquidity classification be the same across funds, but that the process used to evaluate liquidity be the same. Panelists discussed the possibility of automating a portion of the process, possibly using technology to highlight candidates for possible changes in liquidity status, with a closer evaluation to be conducted manually. A panelist said that, in his opinion, the hard question is how substan-

tial a change in circumstances needs to be in order to trigger a detailed re-look at a security's liquidity. Panelists discussed fund boards' responsibilities generally, focusing on timing in particular. They noted that, assuming boards will need some number of meetings to develop and become comfortable with board reporting protocols and formats, they might, in fact, want to begin that review and comment process in early 2018.

The panel noted that a "highly liquid investment" includes any investment that the fund reasonably expects to be convertible into cash in three business days or less without significantly diluting the remaining shareholders' interests. Panelists noted that the determination as to what amount of a security may be traded without resulting in a "significant change" in market value would require both quantitative and qualitative inputs. They said that a fund group would likely want to rely for the quantitative analysis on trading data available to it, but that, for the qualitative analysis, it would likely want to rely on the long experience of its trading desk personnel. They agreed that it will be difficult to develop hard and fast rules as to what constitutes a significant change, and that the ultimate determination will depend to a significant extent on trader input.

In this regard, panelists noted the special challenges posed by fixed-income securities. They said that, by contrast to many equity securities, for which there is substantial trading data, trading information is not available for many fixed-income securities, and that some amount of modeling will likely be required. They noted that market depth is a real issue for many fixed-income securities, and that liquidity determinations for those securities will likely require a significant amount of qualitative input from traders and portfolio management personnel.

The panel discussed liquidity considerations relating to senior loans. Panelists noted that the "less liquid" classification bucket appears to have been developed by the SEC largely with senior loans in mind, in light of the extended settlement periods for many loans. A panelist noted that it is fortunate that the SEC included the availability of lines of credit among the factors a fund may consider in periodically determining liquidity risk, since lines of credit have helped to make senior loans appropriate for use in open-end funds. A panelist discussed whether a senior loan might be characterized as a "moderately liquid investment." He noted the difficulty in developing assurance of seven-day settlement ex ante, noting that it would likely be possible to do that in certain cases, but that it might be difficult in many cases.

Panelists noted that public disclosures regarding liquidity are likely to bring more "market discipline" to funds with high illiquidity. They noted that investors and consultants will likely look more carefully at fund liquidity, and it is possible that less liquid funds will not grow as large as they have in the past.

Panelists noted that it is unlikely that many funds will exceed their highly liquid investment minimums, since most funds will probably be run with a level of liquidity substantially higher than the minimums. They noted the difficulty of considering long- and short-term cash flow projections where the fund manager does not have transparency through to underlying holders of omnibus accounts. They noted that, in such cases, funds may simply "assume the worst" and set a cushion. A panelist said that policies and procedures seeking or requiring early large trade warnings may become more common. Panelists noted that funds that have been in existence longer will have an advantage in setting their highly liquid investment minimums, since they can rely on historical data to some extent. One panelist noted that determination of a highly liquid investment minimum is not required of a fund that does not primarily hold assets that are highly

liquid investments; the panelist said that the word in the industry is that the SEC staff will construe that status "very narrowly."

SESSION 3-B

Retirement Redux: Where Does Regulation Go from Here?

Moderator: Elena Barone Chism, Associate General Counsel, Investment Company Institute

Speakers: Jason Bortz, Senior Counsel, Capital Group

Robert A. Holcomb, Vice President, Legislative and Regulatory Affairs, Empower Retirement

Margaret H. Raymond, Vice President, Managing Counsel, T. Rowe Price Associates, Inc.

Ms. Chism outlined the three topics to be covered by this panel: (i) the DOL fiduciary rule, (ii) state-run retirement plans for private-sector workers and (iii) tax reform and other possible retirement legislation.

Mr. Holcomb provided an update on the status of the fiduciary rule. He noted that the November election results created significant uncertainty as to when or if the rule would take effect. Mr. Holcomb indicated that the DOL had proposed to delay the applicability date from April 10, 2017 to June 9, 2017, and that this delay is widely expected to take place. He noted that the deadline for comments on the re-examination of the rule and its exemptions pursuant to the February 3 Presidential memorandum is April 16, 2017, at which time the industry should have a better sense of next steps. The panelists speculated regarding the most likely outcome for the fiduciary rule and agreed that revisions are more likely than outright rescission. Mr. Bortz noted that it would be challenging for a new Secretary of Labor to rescind the fiduciary rule without facing litigation from various public interest groups. Mr. Bortz discussed the impact of the fiduciary rule to date on fund distribution models, noting that the status of "Class T" shares was uncertain given that they were designed to solve specific issues raised by a rule that is likely to change. The panelists observed that litigation risk is a significant concern under the current iteration of fiduciary rule, and that some FAQs published to date by the DOL seem more helpful to plaintiffs' firms than to those trying to follow the Rule. The panelists discussed aspects of the Rule they would most like to see addressed through revisions, including clearer guidance regarding whether certain activities are "advice" or "education," more limited disclosure requirements, and greater choice as to the structure of compensation paid for advice (e.g., asset-based fees, commissions).

Ms. Raymond provided an overview of recent developments relating to state-run retirement plans. She noted that several states have already created plans aimed at workers without access to workplace plans, and a number of other states are considering legislation to create new state-run programs. Mr. Bortz noted that the idea underlying these plans is that workers without workplace plans represent an underserved population, and that states are stepping in to address a market failure. He noted that the sponsoring state generally subsidizes the administrative costs of supporting these plans, effectively providing state-sponsored competition to private markets. Mr. Holcomb observed that these are well-intentioned statutes, but it is not clear they will succeed or whether investors would be better off if private markets (rather than states) filled this void.

Mr. Holcomb discussed elements of possible tax reforms and other retirement legislation that could be introduced in the coming months. He noted that tax reform appears to be the Trump administration's number two priority after health care. The panelists

speculated regarding the structure of future tax reforms, including possible movement toward Roth treatment of contributions (with only some limited portion of the maximum contribution permitted to be made on a pre-tax basis) and possible reduced limits for contributions and/or deductions. The panelists speculated regarding the potential impact of these sorts of changes on retirement savings, including reduced savings rates and the risk that balances will be insufficient to last through retirement.

SESSION 3-C

Variable Insurance Products at a Crossroads: Opportunities and Challenges

Moderator: Sarah A. Bessin, Associate General Counsel, Securities Regulation, Investment Company Institute

Speakers: Susan S. Krawczyk, Partner, Eversheds Sutherland (US) LLP

Michael J. Mazza, Assistant General Counsel, Northwestern Mutual

Tamiko Toland, Agility Retirement Income Intelligence

The panel discussed the structure of variable insurance products, the impact of the fiduciary rule on those products, and recent industry trends and key areas of regulatory focus relating to those products.

Variable Insurance Product Structure. Mr. Mazza reviewed the structure of a typical variable insurance product, noting that insurance company separate accounts are investment companies, typically unit investment trusts, the assets of which are insulated against claims of the insurance company's creditors. He explained that *Prudential Ins. Co. v. SEC* (3rd Cir. 1964) had held that an insurance company is the sponsor and depositor of its separate accounts, but is not itself an investment company.

Fiduciary Rule Impact. Ms. Krawczyk opined that the adoption of the fiduciary rule had been the biggest event affecting the variable insurance product industry in 2016. She noted that the DOL had proposed to delay the fiduciary rule's April 10, 2017 compliance date for 60 days and that it was difficult to predict when or whether the fiduciary rule would ultimately take effect. Ms. Krawczyk reported that, on March 10, 2017, the DOL had published a field assistance bulletin indicating that, in the event the delay is implemented after April 10 or no final action has been taken on the delay after April 10, it would not seek to enforce the fiduciary rule during the gap period. She noted, however, that the effect of that position with respect to individual retirement accounts (IRAs) was unclear, as the DOL does not have enforcement authority with respect to IRAs. Mr. Mazza stated his understanding that most insurance companies were currently planning on delaying the mailing of the special notice required for reliance on the fiduciary rule's "Best Interest Contract" exemption during the transition period until there was more certainty regarding the implementation of the fiduciary rule.

Ms. Krawczyk discussed some of the special challenges the fiduciary rule posed in the variable annuity context. She stated that the SEC's recent no-action letter to Capital Research and Management Company contemplated that brokers relying on the letter to externalize sales charges for "clean shares" would be acting as agents of the investor, rather than the issuer, but noted that, under state insurance regulations, representatives selling variable annuities are required to be agents of the selling insurance company. Ms. Krawczyk also noted that because the holders of variable annuities typically make ongoing investments, the fiduciary rule's provisions grandfathering sales made prior to April 10, 2017 were unlikely to be very helpful. Ms. Krawczyk reported that, since

the adoption of the fiduciary rule, many intermediaries had sought to withdraw as broker of record for variable annuities. She noted that this could have implications for the provision of ongoing services to, and the maintenance of records for, variable annuity customers.

Industry Trends. Mr. Mazza described the range of underlying funds serving as investment options for variable annuity contracts, noting that the average variable annuity contract offered 75-100 underlying fund investment options. He noted that recent money market reforms had prompted many separate accounts to substitute government money market funds for institutional prime money market funds. Mr. Mazza noted that there was increasing interest in advisor annuities, for which the representative receives ongoing advisory fees, but no sales compensation.

Ms. Krawczyk stated that L share annuities had declined in popularity in 2016 due to FINRA enforcement actions generally taking the position that the pricing of L shares, which typically bear higher asset-based mortality and expense risk charges than B share annuities and are generally most appropriate for investors expecting to liquidate the annuity in a relatively short time, are inconsistent with long-term benefit riders.

In response to a question from the audience, Mr. Mazza stated that the fiduciary rule had sensitized insurance companies to the differences between qualified and non-qualified accounts, and he expected to see greater differentiation in the products offered to qualified and non-qualified accounts going forward.

Areas of Regulatory Focus. Ms. Krawczyk summarized the SEC's 2016 investor bulletin with respect to insurance contract buyout offers and replacements, noting that the bulletin provides helpful insight into relevant risk considerations. She also observed that replacements are subject to FINRA rules, and that some state insurance departments have developed regulations governing supervision, suitability and disclosure obligations in connection with replacements.

Ms. Krawczyk noted that variable annuities were mentioned in the 2017 regulatory priorities of both FINRA and the SEC.

GENERAL SESSION

A Conversation with OCIE and Enforcement

Moderator: Christopher Michailoff, Director, Deutsche Bank, LP

Speakers: Stephanie Avakian, Acting Director, Division of Enforcement, U.S. Securities and Exchange Commission

Peter Driscoll, Acting Director, Office of Compliance Inspections and Examinations, U.S. Securities and Exchange Commission

Lorraine B. Echavarria, Partner, Wilmer Cutler Pickering Hale and Dorr LLP

The panel provided the opportunity for attendees to hear first-hand about some of the priorities of the SEC's Office of Compliance Inspections and Examinations (OCIE) and Division of Enforcement (Enforcement).

Enforcement Priorities. Ms. Avakian indicated that Enforcement is looking to bring impactful cases that improve efforts to protect investors by leveraging the technology and data available to the staff, noting the staff's focus on protecting retail investors from online "cyber" attacks and scams.

OCIE Priorities. Mr. Driscoll discussed OCIE's goal to take a risk-based, data-driven approach to conducting narrow, deep dive reviews of key risk areas. He detailed OCIE's exam priorities, including a focus on retail investors, seniors and retirement assets and market risk related to technology and ex-

change controls. He then described how OCIE determines exam priorities, taking input from the examination staff and the regional offices, as well as the SEC's risk and surveillance teams, before engaging with other SEC branches and the Commissioners. He then described the top five areas where OCIE makes findings – custody, codes of ethics, compliance and books and records rules and SEC registration.

Reasons for Enforcement Referrals. The panel noted that the principal reasons for Enforcement referrals are (i) fraud, (ii) likelihood of serious harm to investors, (iii) recidivist activity, (iv) magnitude of potential or actual harm, (v) length of violations, (vi) concern for dissipation of investor assets and (vii) non-cooperation. The panel also discussed how referrals might occur, including as a result of conversations between OCIE and Enforcement during exams. In response to an audience question, the panelists indicated that it is important to get the facts right during an SEC exam to avoid a potential referral, so exam subjects should speak out to make sure the record is complete and accurate before the conclusion of an exam. Often, the exit interview will provide an appropriate opportunity for an exam subject to make any additional facts known to OCIE.

Privilege. With respect to claims of privilege for mock exams conducted prior to an OCIE exam, OCIE does not take a negative view of the assertion of privilege, but did suggest that maintaining a privilege log will help clarify the issue should OCIE later seek privileged materials. Ms. Avakian indicated that Enforcement does see tension where there is an informal assertion of privilege based on a reliance on counsel claim. While Ms. Echavarria then noted that an exam or enforcement subject does not need to waive privilege to be cooperative with the staff, she said that if a firm does waive privilege, it typically receives cooperation credit from the staff. Ms. Echavarria mentioned that she typically advises clients not to waive privilege early in the process because a waiver to the SEC will probably also result in a waiver for third parties, including future plaintiffs. She then detailed other ways an exam subject can demonstrate cooperation, including providing non-privileged documents and making witnesses available. She added that, if she does advise a client to waive privilege, such waivers tend to be limited.

Enforcement Activity. Next, the panel discussed OCIE referrals to Enforcement, with Ms. Avakian noting that most, but not all, of the 10% of OCIE exams that result in referrals lead to investigations by Enforcement, while 70% of exams result in deficiency letters and 20% result in no comments. She noted that former Chair White's "broken windows" enforcement approach, which targets stand-alone, technical violations, has not yet been changed but may be deprioritized by the next SEC Chair. It was noted that registrants who take immediate corrective action in response to issues raised internally or by the SEC staff will be better off.

Self-Reporting. The panel then discussed self-reporting of actual or potential violations by registrants. The SEC staff advises registrants to reach out to OCIE or the relevant SEC division to notify them about violations. It was noted that registrants typically receive credit for self-reporting issues and for taking steps at remediation. Ms. Echavarria stated that considerations with respect to self-reporting include the seriousness of the conduct, the potential for the conduct to become a significant story when reported, the seniority of the individual involved in the conduct, the amount of money involved and whether the registrant has conducted an internal investigation. Another factor to consider is whether the SEC's whistleblower rules will apply, because if a registrant fails to self-

report a matter that is later reported by a whistleblower, the consequences may be more severe.

OCIE and Enforcement Practices. The panel first noted that while OCIE typically cites registrants for violations of the law, it will also cite failures to comply with informal SEC staff guidance. In contrast, it was noted that Enforcement referrals must be based on violations of law. Next, the panel discussed staff interview approaches. OCIE often seeks to interview attorneys and firm CCOs to obtain a complete picture of the registrant's activities, while Enforcement rarely puts attorneys on the record. Enforcement views interviewing CCOs as necessary and appropriate in most instances. The panel noted that both OCIE and Enforcement are seeking to interview fund directors with increasing frequency.

Data Collection and Analysis. The panel explained that both OCIE and Enforcement increasingly rely upon data to shape and perform examinations and investigations. It was suggested that compliance professionals attempt to analyze firm data to anticipate what areas the SEC staff may focus on. Mr. Driscoll described an analytical tool the staff has developed to review trade blotters and run approximately 50 different reports, and he suggested that registrants take a similar approach to analyzing firm trade data.

Additional OCIE and Enforcement Topics. Finally, the panel discussed likely future issues, including a focus on robo-advisers and other forms of algorithmic advice. There was also discussion of the recent 10th Circuit's decision regarding the SEC's administrative law judge function. In addition, the panelists discussed recent criticism of penalties imposed on public companies that punish public shareholders rather than the individuals involved in misconduct.

SESSION 4-A

Derivatives Market Reform: Where Are We Going Now That We Are Almost There?

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

Speakers: Leigh R. Fraser, Partner, Ropes & Gray LLP

Jason M. Goggins, Managing Director, Daly Consulting Group

Tracey Jordal, Executive Vice President, Senior Counsel, PIMCO LLC

This panel discussed the status of derivatives market reform, the effects of derivatives market reform on markets and market participants and potential future changes to derivatives regulation.

Reporting Requirements. Ms. Choi stated that, under the new reporting requirements in the United States implemented in connection with the Dodd-Frank Act, generally the swap dealer who is party to the swap must report swap transactions either to a swap data repository or directly to the SEC or CFTC. She noted that, pursuant to the European Market Infrastructure Regulation (EMIR), each party to a swap transaction that is an entity established in the EU must report certain trade information to an EU trade repository.

Clearing Requirements. Ms. Choi stated that, while the SEC has not yet proposed clearing requirements for security-based swaps, the CFTC has implemented clearing requirements for interest rate swaps in certain currencies and credit default swaps on certain indices. She noted that clearing requirements for interest rate swaps in certain other currencies are being phased in over time. She stated that there is a similar clearing requirement in the EU on a

narrower band of swaps that will affect funds or other entities established in the EU and U.S. accounts trading with EU-based counterparties.

Trading Requirements. Ms. Fraser explained that a subset of the swap transactions required to be cleared must trade either on an exchange or on a swap execution facility (SEF). She stated that benchmark interest rate swaps and credit default index swaps are currently required to be executed on a SEF and additional categories of swaps may be subject to this requirement over time. She noted that the SEC has not yet proposed any trading requirements for security-based swaps and that, in the EU, trading requirements are expected under MiFID II, although details regarding those requirements are not yet known.

Ms. Fraser described the mandatory minimum margin requirements for uncleared swaps in the United States. She noted the March 1 compliance date for variation margin requirements and commented that many funds in the industry were still in the process of finalizing their documents. She described initial margin requirements that will become effective in 2020 and noted that these requirements apply only to funds with material swap exposure (*i.e.*, $8 billion in notional amount, with deliverable currency forwards counting toward the threshold). Ms. Fraser described mandatory minimum margin requirements in the EU, highlighting the fact that the U.S. requirements apply only to dealers, but any entity established in the EU is subject to the EU rules.

The Effects of Derivatives Market Reform. The panelists discussed the changes they have seen in the derivatives market as a result of the reform. Ms. Jordal commented that derivatives market reform has resulted in a more stable financial system. She noted that there are more barriers to derivatives trading now, but that some of the changes resulting from the reform (clearing requirements, for example) may have evolved in the market naturally due to risk management benefits. Ms. Fraser stated that she has not seen a material change in the overall use of derivatives by funds. She noted that funds that do not expect to use derivatives extensively may be deterred by the additional steps that must be taken in connection with derivatives trading but, in general, funds that use derivatives as a core part of their strategy have simply complied with the additional requirements.

Potential Future Changes to Derivatives Reform. The panelists agreed that a wholesale repeal of Title VII of the Dodd-Frank Act, which provides the framework for the regulation of the swaps markets, is not practical or likely. Mr. Goggins discussed the potential impact of the Financial CHOICE Act and CFTC Reauthorization Bill on Title VII. The panelists then discussed certain issues with the current requirements, which may be the subject of further reform.

Ms. Jordal discussed the need for potential reform relating to the capital requirements for banks under Basel III. She noted that the capital requirements have increased the cost of accepting clearing accounts and some futures commission merchants have exited the business as a result. Mr. Goggins stated that he did not expect Congress to address the concerns related to stricter capital requirements, despite the fact that the Financial Stability Oversight Council has been tasked with evaluating how rules implemented pursuant to the Dodd-Frank Act are impacting markets.

Ms. Fraser noted issues with the minimum transfer amount for variation margin. She explained that the U.S. variation margin rules provide that margin does not need to be posted until the amount to be transferred exceeds $500,000 of combined initial and variation margin. She stated that, while this is helpful relief, the cap is applied at the legal entity level, which

results in issues for funds with multiple managers and for investment advisers to separately managed accounts because managers typically do not know what exposures other managers have put on.

Ms. Jordal noted the conflict of interest relating to the fact that SEFs can, in effect, determine which swaps must be traded on a SEF. She stated her view that the CFTC should be responsible for determining which swaps need to be traded on a SEF in order to avoid this conflict. Mr. Goggins stated that SEFs were addressed in the 2015 white paper issued by CFTC Acting Chairman Giancarlo. He noted that the white paper reflected Mr. Giancarlo's view that market participants should be able to choose how to trade without having the process dictated by the government.

Ms. Fraser stressed the need for a unified cross-border framework for swaps regulation, as funds trading in multiple regions are currently required to comply with multiple sets of requirements that are not aligned. She noted that the G20 leaders agreed that derivatives regulation is important to a well-functioning market and agreed on a general overall regulatory framework, but that significant cross-border issues remain. As an example of the misalignment, she noted the fact that the cutoff time for posting variation margin is T+1 under the EU rules and T+0 in the United States. Ms. Jordal agreed that if a cross-border framework is not implemented, a fund's ability to trade globally may be hampered. Mr. Goggins added that conflicting jurisdictional requirements could result in regional trading with higher risk concentration, which would be contrary to the intent of the Dodd-Frank Act.

In concluding the panel, the panelists reiterated that, while there are multiple bills moving through Congress that could potentially impact derivatives market regulation, most of the existing regulation is likely here to stay.

SESSION 4-B

Tax Reform: What Does it Mean for the Fund Industry and Fund Investors?

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

Speakers: Marc J. Gerson, Partner, Miller & Chevalier

Joshua D. Odintz, Partner, Baker & McKenzie LLP

Gwen Shaneyfelt, Senior Vice President, Global Taxation, Franklin Templeton Investments

This panel focused on the prospects for tax reform and the potential impact on the mutual fund industry and fund investors.

Opportunity for Tax Reform. The panel began with an overview of the post-election composition of Congress and the presidential administration and the prospects for enacting tax reform. Mr. Odintz noted that, while Republicans hold 52 seats in the Senate, they do not have the 60-vote "supermajority" needed to defeat a filibuster. In addition, he said that despite the Republican majority in the House of Representatives, Speaker Ryan will need to simultaneously manage both a divided Republican caucus and his sometimes-turbulent relationship with President Trump. Mr. Gerson then observed that no one has yet been nominated for the position of Assistant Secretary for Tax Policy, and that the person that fills this role will likely be a key player in passing tax reform.

The discussion also focused on the process for passing comprehensive tax reform. Mr. Gerson noted that whether there is sufficient time to complete comprehensive tax reform in 2017 very much depends on

the timing of the effort to "repeal and replace" the Affordable Care Act (ACA). He said that the House Ways and Means and Senate Finance Committees are involved in both the ACA and tax reform, and much time and political capital may well be spent completing health care legislation, leaving less time and energy for tax reform.

The panel noted that Senate Democrats have been silent regarding their views, making the likelihood of comprehensive tax reform uncertain. It was also noted that, in the absence of obtaining 60 votes to defeat a potential filibuster, a tax reform bill can be passed using the budget reconciliation process, which, because the process is not subject to a filibuster, requires only a 51-vote majority. The panel noted that this would eliminate the need to negotiate with Senate Democrats, but support of the entire Republican caucus would need to be maintained. Using the reconciliation process would mean that the bill could not be amended, providing less opportunity for compromise to address taxpayer concerns. It was also noted that, because legislation passed through this process could not increase the deficit outside the ten-year budget window, provisions of the legislation that would so increase the deficit would expire after ten years (absent subsequent legislative action), creating uncertainty for taxpayers. Mr. Gerson said that, in the current environment, there is significant bipartisan agreement on some items, but the parties are likely too far apart on other items to complete bipartisan comprehensive tax reform.

Current Tax Reform Proposals & Effect on the Fund Industry. Mr. Odintz provided an overview of President Trump's tax plan, which includes a cut in tax rates for all brackets and would permit businesses to expense (i.e., deduct) new business investments. That plan also would impose a 10% tax rate on repatriated earnings. He said that the administration anticipates releasing an outline that will address tax rates, international tax reforms and plans to grow jobs. No other details have been provided, and the outline is not expected to discuss how to pay for the proposal.

Mr. Odintz went on to summarize some of the key provisions of the House "Blueprint," which was released by House Republicans in June 2016 and is currently viewed as the base document for tax reform. With respect to individuals, he said that the House Blueprint would, among other things, reduce the top individual tax rate to 33%, provide for a 50% exclusion for capital gains and dividends, and eliminate itemized deductions other than for charitable contributions and mortgage interest. For businesses, the House Blueprint proposes to reduce the top corporate tax rate to 20%, allow for full expensing, and eliminate the deduction of business interest expense. Several changes would be made in the international arena as well, including deemed repatriation of foreign earnings (with an 8.75% tax rate on cash and cash equivalents and a 3.5% rate on non-cash investments), repealing the controlled foreign corporation (CFC) rules, and adding a new border adjustment mechanism (border adjustment tax) to exempt exports and tax imports.

Ms. Shaneyfelt then turned to the impact of tax reform on the investment management industry. She said that the impact of the border adjustment tax on funds, for example, was unclear. She said that U.S. funds that have custodians or advisers abroad presumably cannot deduct fees paid to such service providers, and it is unclear how dividends and interest from non-U.S. companies would be taxed. In addition, the repeal of the CFC rules would implicate funds' investments in non-U.S., wholly-owned subsidiaries.

Ms. Shaneyfelt said that, while the proposed lower tax rates generally would be favorable for investment managers, the ultimate effect of tax reform depends on a variety of factors particular to each firm.

For example, if a U.S. investment manager hires an offshore service center to provide services in the U.S., the investment manager would not receive a deduction for the related expense. On the other hand, a U.S. investment manager that advises an offshore fund would not be taxed on the management fees received and would still be able to deduct its expenses. More generally, the panel noted that the House Blueprint does not specifically address financial services, and, thus, the effect on funds and investment managers is not clear.

Taxation of Derivatives & Regulated Investment Company (RIC) Modernization II. Ms. Gibian discussed proposed changes regarding the taxation of derivatives. Proposals over the last two years have all provided that derivatives be marked to market and that any resulting gain or loss be ordinary. She said that a discussion draft released in May 2016 on which the ICI commented also proposed a new investment hedging unit regime, which is intended to simplify the straddle rules. The panel noted that derivatives tax reform is expected to be folded into broader tax reform.

Ms. Gibian then stated that the ICI is considering whether it makes sense to pursue a “RIC Mod II” to achieve RIC-specific legislative changes. For example, such a proposal could include (i) permitting RICs to use net operating loss carryforwards, (ii) making income from commodities qualifying income and (iii) fixing certain excise tax provisions.

The panel concluded with predictions on the passage of tax reform. The panelists all believe that some form of legislation will be passed this year, but the content of such legislation is unclear.

SESSION 4-C

Surviving the Aftershocks: Fund Distribution After the DOL’s Seismic Fiduciary Rulemaking

Moderator: Linda M. French, Counsel, Securities Regulation, Investment Company Institute

Speakers: Judith R. Hogan, Senior Vice President and Associate General Counsel, MFS Investment Management

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

James G. Whetzel, Vice President and General Counsel, USAA

Rana Jewel Wright, Assistant General Counsel, Bank of America Merrill Lynch

The panel discussed the background of the DOL’s fiduciary rule, the fund industry’s reactions to the fiduciary rule, relevant SEC staff guidance with respect to new share class offerings and the future of the competitive landscape under the rule.

Fiduciary Rule Background. The panel first reviewed various elements of the fiduciary rule, including the “Best Interest Contract” exemption (the BIC exemption), which is designed to permit certain types of compensation that would otherwise be prohibited if advisers and financial institutions meet specific requirements. Mr. Purple noted that the definition of “recommendation” under the fiduciary rule was broad and that many intermediaries would be considered “fiduciaries” under the rule and, thus, prohibited from receiving compensation for covered recommendations absent an exemption (such as the BIC exemption).

Industry Reactions to Fiduciary Rule. Ms. Hogan stated that there have been a multitude of reactions to the fiduciary rule since it was finalized and that financial intermediaries have been making numerous and

evolving requests for changes in the share class and/or sales charge structures of the funds offered on their platforms. Mr. Whetzel noted that his firm has taken a "wait and see" approach in light of the recently-proposed 60-day delay in the applicability date of the rule, but that his firm is ready to comply with the fiduciary rule requirements if and when they take effect. Ms. Wright noted that her firm has proceeded under the assumption that the fiduciary rule will take effect in its current form and that her firm has announced its intention to terminate the sale of any funds offered on its platform that do not have an appropriate share class structure in place.

The panel also discussed the recent launch of Class T shares by numerous fund complexes. Mr. Purple said that he believed that the growth of Class T shares was the collective result of industry efforts to create a single share class that could be responsive to the varying business demands of numerous financial intermediaries.

SEC Staff Guidance on New Share Classes and "Clean Shares." Mr. Purple stated that, in December of 2016, the SEC's Division of Investment Management issued a Guidance Update titled "Mutual Fund Fee Structures" that focused on disclosure issues and procedural requirements arising from funds offering intermediary-specific variations of their sales loads and funds offering a new share class. He explained that, according to the guidance and subject to several conditions, the SEC staff would not object if sales load variation disclosure applicable to multiple intermediaries were included in an appendix to a fund's prospectus.

The panel then discussed the January 11, 2017 SEC staff no-action letter to Capital Research and Management Company. Mr. Purple said that, in the letter, the SEC staff confirmed that the restrictions of Section 22(d) of the 1940 Act do not apply to a broker-dealer when, as agent on behalf of its customers, the broker-dealer charges its customers commissions for effecting transactions in "clean shares" of a fund (i.e., a share class without any front-end loads, deferred sales charges or other asset-based fees for sales or distribution). The panel noted that the no-action letter took no position with respect to whether a broker-dealer's receipt of revenue sharing payments would prevent it from relying on the letter and that more guidance in this area could be helpful.

Future of Competitive Landscape. The panel concluded with a discussion of the panelists' views on the future of the fund industry competitive landscape under the fiduciary rule. Ms. Hogan said that she believed the industry would undergo a share class rationalization, with relatively small, poorly-selling share classes being eliminated. Ms. Wright concurred and noted that her firm had also begun a rationalization effort with respect to fund offerings on its platform. Mr. Whetzel stated that he believed that the fiduciary rule would lead to greater simplicity and transparency in the retail product environment.

SESSION 5-A

Crashing the (Third) Parties: Mitigating Risk Through Service Provider Oversight

Moderator: Matthew Thornton, Assistant General Counsel, Securities Regulation, Investment Company Institute

Speaker: Canise Arredondo, Senior Vice President, Risk Management and Chief Compliance Officer, The Capital Group Companies, Inc.

Joseph A. Carrier, Chief Risk Officer, Legg Mason, Inc.

Rhonda K.R. Cook, Director, Third Party Risk Management, SEI

This panel examined the importance of vendor monitoring and risk management in the context of both business continuity and operational effectiveness of a fund complex.

Importance of Monitoring Vendors. Mr. Thornton explained that, while eliminating all vendor-related risk may not be practicable, thoughtful and diligent vendor risk management can reduce a fund complex's level of risk in several areas. Mr. Carrier, highlighting the importance of vendors, noted that, if a service fails, fund shareholders may hold the fund complex, and not the vendor, accountable. In other words, Mr. Carrier stated, while firms can outsource the activity, they cannot ultimately outsource the responsibility.

Oversight of a Vendor and Proportionality to Risk. The panel discussed how vendors' risk profiles and their criticality to operations vary widely and advised that a firm's oversight over a particular vendor should be proportional to the risk that the vendor presents. For example, Ms. Cook said that firms may want to closely examine and monitor vendors that have access to protected information, vendors that have access to systems that can move cash or funds, vendors that perform services that are critical to an organization's business and vendors that have access to the organization's intellectual property and/or other proprietary information.

Vendor Diligence Process. The panel also examined what the vendor diligence process entails, underscoring the importance of considering whether a vendor shares the firm's goals and values, examining how a vendor invests in sustaining the capabilities that the firm has hired (or will hire) it to perform, and understanding whether and to what extent the vendor sub-contracts services to "fourth-party providers." Ongoing monitoring of a vendor, the panel noted, should include tasks such as adherence to service level agreements, performance quality, market information and news regarding the vendor and quality of the vendor relationship. Periodic reviews, which should be done as frequently as the vendor's risk profile would suggest, may include tasks such as know-your-customer and anti-money laundering screening and evaluation of financial stability. Depending on the results of the periodic monitoring, the panel noted that a firm may wish to ask the vendor for more information in order to determine whether the vendor continues to be a good match for the firm.

Collaboration with Peers. The panel then discussed issues associated with peer collaboration regarding vendors and their performance of services. Ms. Arredondo said that, if many firms in the industry use one vendor for a particular service, collaboration among these firms can be a good way to stay apprised of the risks and other issues that the vendor faces. Ms. Cook also noted that, where many firms use the same provider, it is important to understand whether, in the event of a service disruption, the vendor would simultaneously recover services for all of its clients or whether there would be a pecking order and,

in the latter case, where in that order your organization would fall.

SESSION 5-B

Mind the GAAP: Accounting and Auditing Update

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

Speakers: Michael Barkman, Partner, Ernst & Young LLP, Chair, AICPA Investment Companies Expert Panel

Stephanie Dorsey, Senior Vice President, Fidelity Investments

Matthew Giordano, Chief Accountant, Disclosure Review and Accounting Office, Division of Investment Management, U.S. Securities and Exchange Commission

This panel discussed recent accounting developments related to mutual funds from the SEC staff, the AICPA Investment Companies Expert Panel, the Financial Accounting Standards Board and the Public Company Accounting Oversight Board.

Accounting for Cleared Swaps. Mr. Barkman discussed a paper the AICPA Investment Companies Expert Panel recently submitted to the SEC regarding the accounting treatment for cleared swaps. He said that two swaps clearinghouses – the CME and the LCH – recently revised their rulebooks to provide that mark-to-market payments with respect to cleared swaps are treated as settlement payments, rather than as variation margin payments. He noted that this change makes the treatment of such payments for cleared swaps under clearinghouse rules similar to the treatment for mark-to-market payments for futures. Mr. Barkman explained that the paper described two possible accounting approaches for such payments – unrealized gains/losses (since the payments relate to open contracts that could change in value) or realized gains/losses (since the payments are settlement payments rather than margin). Mr. Giordano confirmed that the SEC staff would not object to either approach, although he believed treating such payments as unrealized gains/losses made the most sense.

FASB Updates. Ms. Dorsey described a proposal under consideration by the Financial Accounting Standards Board that would define "materiality" for purposes of financial statement disclosure in accordance with the standard articulated by the U.S. Supreme Court for federal securities law purposes (significantly altering the "total mix" of information made available).

Ms. Dorsey also explained a recent change to the accounting treatment for premium amortization on purchased callable debt (under ASC 310). She said that, previously, such amounts would be measured on the basis of yield to maturity but that, under the new practice, they would be measured on the basis of yield to first call. She clarified that this treatment applied only to debt with stated calls (and not, for example, to asset-backed securities).

Auditor Reporting Model. Mr. Barkman described a proposal by the Public Company Accounting Oversight Board that would require a description of critical audit matters in audit opinion letters. He explained that audit letters for registered investment companies were not covered by this requirement, because it was understood that, under typical circumstances, the only critical audit matter for such entities would be valuation. He noted, however, that audit opinions for business development companies would have to include this information under the proposal.

SEC Staff Comments on Financial Statements. Mr. Giordano explained that the SEC staff was aiming

to standardize comments on financial statements for mutual funds. He noted that, in the short term, this effort had led to an increase in the typical number of comments on fund financial statements but that he expected, over the long term, it would decrease the number of comments. He also said that the SEC staff was taking a risk-based approach to review of financial statements, looking at whether fund investments conformed to the fund's policies and disclosure. He also noted that he expected the SEC staff would issue an FAQ with respect to the recent amendments to Regulation S-X.

SESSION 5-C

Are You Ready for Some Fun(d Reporting)? Implementing the SEC's New Reporting Modernization Rules

Moderator: Kenneth C. Fang, Assistant General Counsel, Securities Regulation, Investment Company Institute

Speaker: Rajib Chanda, Partner, Simpson Thatcher & Bartlett LLP

Jacob D. Krawitz, Branch Chief, Investment Company Regulation Office, Division of Investment Management, U.S. Securities and Exchange Commission

Stephen P. Van Meter, Chief Compliance Officer, Federated Investors, Inc.

Mr. Chanda discussed the enhanced reporting requirements adopted by the SEC in October 2016. Mr. Chanda discussed new Form N-PORT, noting that it requires detailed portfolio holdings information on derivatives, repurchase and reverse repurchase agreements, securities lending activities, portfolio- and position-level risk analytics, total return and flow information. He noted that Form N-PORT will be filed 30 days after each month end, and the filing for the third month of each fiscal quarter will be made publicly available on a 60-day lag. Mr. Chanda then discussed new Form N-CEN, noting that it replaces Form N-SAR as an annual report due 75 days after a fund's fiscal year end. He stated that Form N-CEN requires certain census-type information, including information about reliance upon certain rules under the 1940 Act and exemptive orders. He noted that Form N-CEN will require detail on securities lending arrangements, lines of credit and interfund lending, as well as share reprocessing information (which is not currently available in SEC filings). Mr. Chanda also commented on amendments to Regulation S-X that will require enhanced reporting on derivatives.

Mr. Krawitz then discussed how the SEC's Division of Economic and Risk Analysis (DERA) will use the data collected from these filings, noting that enhanced data collection will assist DERA in identifying risk trends and outliers. Mr. Krawitz stated it is likely that the SEC staff will look for "event-focused" trends, and that the SEC's Office of Compliance Inspections and Examinations (OCIE) will use these analytics in determining which registrants are examined. Mr. Krawitz noted that the Staff expects that Form N-PORT will be a "game changer" in terms of identifying and assessing trends from a risk perspective. He commented on the SEC's analytical capabilities, and noted that the Staff uses a natural language tool to review data in addition to its review of numbers.

Mr. Van Meter then discussed the new reporting requirements from an issuer's perspective, and described the resources that will be needed for a large fund complex to handle these new filings. He noted that fund complexes will be looking to their service providers – custodians, transfer agents and administrators – for assistance. He discussed the pros and cons of engaging external service providers for certain reporting metrics versus building those capabili-

ties in-house. In this regard, he noted that the use of external providers would likely help with the scalability of the filings, but noted that in-house capabilities would likely yield other benefits, as the data, once collected, could be analyzed and used for internal risk-metric assessments. In the end, he noted, it is a question of resources for most fund complexes. Mr. Van Meter then commented on the challenges posed by Form N-PORT for those complexes that use multiple sub-advisers, noting that reports for sub-advised funds will require extensive coordination.

Messrs. Chanda and Van Meter then commented on board considerations with regard to the data that is being compiled and reported to the SEC. The panel discussed an adviser's responsibility to notify a board when the adviser realizes that a fund is an outlier. Messrs. Chanda and Van Meter noted that boards may be asked to consider increases in fees paid to service providers due to the increased workload relating to the enhanced reporting requirements. Mr. Van Meter discussed the role of an adviser's disclosure review committee, citing the increase in volume of reports that such committees will have to review once the new reporting requirements go into effect.

The panel then discussed the general timeline for compliance with the new reporting requirements. Mr. Krawitz noted that the staff will issue FAQs, and that the ICI is gathering questions from industry participants for the staff's consideration. Mr. Krawitz urged attendees to submit questions to the ICI.

In conclusion, the panel noted that there is consensus that the information sought to be gathered by the new reporting requirements is crucial to the SEC's mission, and that registrants will work through implementation issues.

GENERAL SESSION

Building Successful and Ethical Teams

Speaker: Nancy B. Rapoport, Special Counsel to the President of UNLV, Garman Turner Gordon Professor of Law, William S. Boyd School of Law, Affiliate Professor of Business Law and Ethics, Lee Business School

Ms. Rapoport discussed the role of teamwork in building an ethical culture, what gets in the way of teamwork, cognitive errors and their effects on collaboration and ethical conduct and the effect of incentives on ethical behavior.

Teams vs. Groups. Ms. Rapoport contrasted the effectiveness of groups and teams, observing that often workplaces are organized into groups rather than teams. She cited benefits of an organized team structure, where it is clear to each team member what he or she is expected to contribute toward the common goal, in contrast to a group structure, where group members might achieve a common goal but with each individual working on his or her own project without understanding fully his or her role in the context of the rest of the group. She explained that, when a team is too large, it is often difficult for each team member to understand each member's role and what he or she is expected to bring to the team.

Obstacles to Effective Teamwork. Ms. Rapoport then focused on the importance of trust among team members and the question of what gets in the way of effective teamwork. She described five key concerns (i) the absence of trust (e.g., being unwilling to speak up when one disagrees with the direction of the team because of a lack of trust that others will listen to or respond well to the person who voiced the concern), (ii) fear of conflict, (iii) lack of commitment, (iv) avoidance of accountability and (v) inattention to details.

To form effective teams, she stated that it is important for a team to consist of members working on these five potential problems and to have a leader who understands how to form a team, who provides effective feedback and who is willing to warn or dismiss someone from the team when he or she is not being a good teammate.

Keys to Ethical Teams. Ms. Rapoport cited as keys for forming strong and ethical teams the following five factors (i) diversity of approach, viewpoint, experience and skills, (ii) using a hub-and-spoke model to avoid having too many people working on the same problem, (iii) clear direction from the top about the team's purpose and expectations of each team member, (iv) constant monitoring to ensure the team is functioning well without intrusive micro-management and (v) tone from the top.

Ms. Rapoport explained that cognitive dissonance (e.g., talking yourself into believing that something was acceptable even though it was not) and social pressures, including peer pressure from one or a small number of people on a team, can lead to unethical team behavior, but awareness of those concerns can help mitigate risk. She also explained that it may be possible to encourage team members to engage in more ethical behavior through the use of incentives, but it is important to be thoughtful and aware of what incentives are already in place in an effort to avoid unintentionally inciting negative behavior. She cited the power of praise and symbolic stories told as part of an organization's cultural lore to influence behavior. She also noted that removing an entitlement generally hurts significantly more than the benefit realized by bestowing a new entitlement.

GENREAL SESSION

Alert Level Red, Yellow, or Green: Where to Focus in the Current Environment

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

Speaker: Kathleen T. Barr, Independent Trustee, William Blair Funds

Joseph A. Carrier, Chief Risk Officer, Legg Mason, Inc.

Andrew J. ("Buddy") Donohue, Former Director, Division of Investment Management, Former Chief of Staff, U.S. Securities and Exchange Commission

Thomas J. Fuccillo, Managing Director and Chief Regulatory Counsel, Head of Funds and Retail Legal, Allianz Global Investors U.S. Holdings LLC

Philip L. Kirstein, Senior Officer and Independent Compliance Officer, Alliance Bernstein

Nancy M. Morris, Managing Director and Chief Compliance Officer, Wellington Management Company LLP

Robert P. Scales, Former CCO and General Counsel, Columbia Acorn Funds, Principal, Robert P. Scales, LLC

In the final session of the conference, panelists were asked to express their level of concern with respect to certain topics pertinent to the fund industry.

Continued SEC Action with Respect to Distribution in Guise. The panel generally agreed that there was moderate concern with respect to the SEC staff's continued actions in this area. Ms. Morris indicated, however, that she harbored little concern because industry participants have addressed the SEC staff's concerns by, for example, revising their policies and procedures. The panel also discussed whether more

SEC investigations could be forthcoming and agreed that there was some concern in this regard.

SEC Rules on Liquidity Risk Management and Data Reporting. The panel's reaction was mixed on this topic. Mr. Fuccillo indicated that, while the industry knows what the rules require, significant work will be required to comply with the rule. Mr. Donohue added that the required liquidity data was important for the SEC to be an effective regulator but acknowledged that the rules are enormously complex. Mr. Carrier countered that the data will have limited utility. Mr. Donohue also noted that the SEC staff may provide publicly, in a manner similar to Form PF data, aggregated data reports that may be beneficial.

SEC Data Security. The panel's reaction was mixed on this topic. Mr. Donohue stated that the issue has reached highest levels at the SEC. Messrs. Fuccillo and Kirstein noted their belief that the opportunity to access industry-wide data in a single database will make the SEC's database too attractive to hackers and others looking to attack the United States via its capital markets. Ms. Morris suggested that the SEC should provide some transparency into its systems and processes to provide some comfort.

Department of Labor Fiduciary Rule. Ms. Morris noted her belief that, even if the fiduciary rule were to be significantly revised or repealed, it may continue to have a significant impact because so much work has already gone into compliance and that business models have already adjusted. Mr. Donohue countered that he believed that there was bias built into the rule against commission-based compensation and that the rule was accelerating changes that would have already occurred absent the rule.

Movement to T+2 Settlement Cycle. The panel generally expressed a low level of concern with respect to the SEC's proposed rule that would shorten the standard securities transaction settlement cycle.

Regulatory Uncertainty in Current Political Environment. Panelist reactions on this topic ranged from a moderate to high level of concern. Mr. Fuccillo noted that, while there is considerable political discussion regarding deregulation, given various hurdles associated with actually effecting regulatory changes, it is uncertain when, if ever, such deregulation may occur. Mr. Donohue suggested that the Director of the Division of Investment Management could focus on setting an agenda that focuses on lessening burdens on fund boards and reducing the length of disclosure documents, initiatives that the SEC staff has been working on for some time but has yet to implement.

Vendor Reliance and Oversight. Panelist reactions on this topic ranged from a moderate to a high level of concern. Ms. Barr highlighted her belief that boards need to better understand the services provided and suggested board visits to service providers to broaden their understanding. Mr. Donohue suggested that firms need to better understand the risks of vendor failures and have plans for dealing with such risks. Mr. Carrier noted that glitches will happen and that the standard for oversight should be reasonable care.

Impact of Proposed Tax Reforms. The panel's reaction regarding proposed U.S. tax reforms was mixed. Most of the panelists felt that the industry could handle any regulation that is likely to be promulgated. Mr. Fuccillo noted that, with a Republican-controlled Congress and a Republican President, it was hard for him to imagine any final tax regulations that would be significantly detrimental to the industry. Ms. Barr, however, noted that certain rumored changes may lead to negative consequences, such as reducing retirement savings if the exemption for income and capital gains within qualified retirement accounts were to be eliminated.

Ransomware. The panel expressed a high level of concern regarding the proliferation of "ransomware," which involves the encryption of data by hackers who prevent owner access until payment of ransom. Mr. Scales noted the potentially heightened effect of these attacks on smaller firms that may have more limited backup systems.

Use of Robotics and Artificial Intelligence in Fund Operations. The panel reaction was mixed on this topic. Mr. Carrier noted that, while there may be early-stage questions around implementation, the use of artificial intelligence in fund operations should prove beneficial to the industry over the long term. The concerns noted by the panelists included oversight of this technology and the potential that it may give rise to unforeseen complexities.

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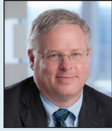

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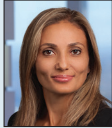

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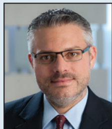

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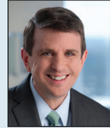

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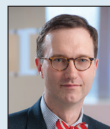

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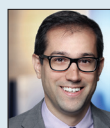

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