SUMMARY

# 2019 MUTUAL FUNDS AND INVESTMENT MANAGEMENT CONFERENCE

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Sponsored by the Investment Company Institute and Federal Bar Association

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## GENERAL COUNSEL'S ADDRESS

**Speaker:** Susan M. Olson, General Counsel, Investment Company Institute

Ms. Olson noted the wide range of regulatory initiatives during 2018 and so far in 2019 that will impact registered funds and their service providers and shareholders. She applauded the SEC staff for generally taking an enterprising and forward-thinking (but measured) approach in attempting to address a number of areas that call for modernization and rationalization. She cited three rulemaking initiatives in particular, including (i) proposed Rule 6c-11 under the 1940 Act (ETF Rule), (ii) proposed Rule 12d1-4 under the 1940 Act (Fund of Funds Rule) and (iii) proposed Rule 18f-4 under the 1940 Act (Derivatives Rule).

*ETF Rule.* Ms. Olsen observed that the ETF Rule proposal represents a careful, thoughtful effort by the SEC to replace the existing patchwork of more than 300 SEC exemptive orders pursuant to which ETFs currently operate. She noted that the exemptive orders have been issued with evolving conditions on a case-by-case basis over many years. She explained that the rule, if adopted, would permit ETFs to satisfy certain conditions to organize and operate without the expense and delay of obtaining an exemptive order from the SEC. She said that the ETF rule would establish a consistent, transparent regulatory framework that should accomplish the SEC's objectives of leveling the playing field among existing ETF sponsors and making it less burdensome and expensive for new entrants, thereby facilitating greater competition and innovation among ETFs. Ms. Olsen commended the SEC for engaging thoughtfully with industry participants to design the ETF Rule, which codifies much of the standard 1940 Act exemptive relief ETFs rely on presently, without imposing new conditions and requirements that would force existing ETFs to dramatically change their structures and potentially threaten the long-term viability of the ETF industry.

*Fund of Funds Rule.* Ms. Olsen noted that, like the proposed ETF Rule, the Fund of Funds Rule is designed to replace a patchwork of SEC exemptive orders, as well as statutory exemptions, SEC rules and SEC staff guidance that currently govern 1940 Act fund of fund arrangements. She said that the SEC's goal of replacing the existing regime with a more consistent and efficient regulatory framework for fund of funds is laudable and worthwhile. She observed, however, that the Fund of Funds Rule, as proposed, would require substantial restructuring of many existing fund of funds arrangements in the industry. Among other proposed new conditions, she highlighted the proposed rule's redemption limits, which would generally restrict an acquiring fund (other than affiliated funds of funds relying on Section 12(d)(1)(G)) that holds more than 3% of an acquired fund's outstanding voting shares from redeeming more than 3% of the acquired fund's outstanding shares in any 30-day period. She commented that the proposed redemption limits may make many existing fund of funds arrangements unworkable, particularly smaller fund of funds. She also questioned the justification for redemption limits, noting that the SEC's new liquidity rule for open-end funds (Rule 22e-4 under the 1940 Act) should go a long way to addressing liquidity concerns that the redemption limits appear designed, in part, to address. She observed that the redemption limits themselves will create complexities and interpretive issues for open-end acquiring funds' liquidity risk management programs. Ms. Olsen encouraged the SEC staff to engage in a constructive dialogue with the industry during the comment period to consider and address these and other problematic aspects of the Fund of Funds Rule.

*Derivatives Rule.* Ms. Olsen noted that the SEC had moved the Derivatives Rule back to its short-term regulatory agenda in 2018, and that the Division of Investment Management (Division) announced that it is considering a recommendation that the SEC re-propose a new rule designed to enhance and modernize the regulatory framework for registered funds' use of derivatives. She commended the SEC for having withdrawn its initial Derivatives Rule proposal issued in 2015, partially in response to concerns expressed by many in the industry during the comment process. She noted that the initial proposal would have unduly restricted funds in using derivatives for useful purposes, including hedging against various portfolio risks, seeking higher returns through increased investment exposures, gaining access to certain markets and achieving greater transaction efficiency. She stated that the SEC staff has been actively seeking input from various industry participants in developing a re-proposal, and that she is optimistic that a re-proposal will be issued in the near term, perhaps by the end of 2019. She is hopeful that a re-proposal will achieve the goal of modernizing and simplifying the current regulatory framework while maintaining sufficient protections for investors, but without unnecessarily limiting funds' use of derivatives for legitimate purposes.

## KEYNOTE REMARKS

### *A Discussion with Dalia Blass*

**Speaker:** Dalia Blass, Director, Division of Investment Management, US Securities and Exchange Commission

Ms. Blass discussed the Division's accomplishments in 2018 and its plans for 2019. In addition, she discussed some trends in asset management and their likely impact on future policy.

*2018 Division Agenda and Accomplishments.* Ms. Blass noted that 2018 was a busy period for the Division, fueled by the goals of improving the investor experience, modernizing regulatory approaches and using the Division's resources with the greatest efficiency possible. She said that improving the investor experience is high on the list of goals, citing initiatives including the SEC's (i) request for comment on improving investment company disclosures, (ii) proposals to improve variable annuity disclosure, including the introduction of summary prospectuses and (iii) adoption of a notice-and-access approach to the delivery of shareholder reports.

Ms. Blass highlighted the SEC's proposals designed to better align the legal requirements and mandatory disclosures applicable to financial professionals with investor expectations. She noted that the Division led the development of the proposed Form CRS "Relationship Summary," which could help stimulate conversations between retail investors and their financial professionals. Ms. Blass also discussed the Division's proposed Advisers Act interpretive guidance, which is intended to clarify the scope of an investment adviser's fiduciary duty. She further noted the Division's support for the development by the Division of Trading and Markets of proposed Regulation Best Interest, which is intended to enhance the standard of conduct of broker-dealers who make recommendations to retail investors.

With respect to modernizing the regulatory framework, Ms. Blass highlighted the Division's recommendations to the SEC regarding a number of new rules and rule proposals, including those relating to ETFs, fund of funds, fund liquidity reporting and fund research reports.

Ms. Blass observed that the Division's modernization efforts extended beyond rulemaking in 2018. She noted the launch of the Division's Board Outreach Initiative, which reviewed and reevaluated what fund boards are asked to do. In this regard, she highlighted the Division's recent no-action letters allowing boards to rely on the CCO certifications under the affiliated transaction rules and relating to in-person meeting requirements. She noted that the Division engaged with many boards and industry representatives in its efforts to update the SEC's valuation and auditing guidance.

*Looking Ahead at 2019.* Ms. Blass highlighted a number of projects the Division will focus on in 2019, including continuing the Investor Experience Initiative, improving investment company and variable annuity fund disclosures and exploring options for a summary shareholder report. She noted that the Division will prioritize delivering to the SEC recommendations regarding Form CRS and interpretive guidance clarifying the scope of investment advisers' fiduciary duty. Additionally, Ms. Blass said the Division will continue to work closely with the Division of Trading and Markets on Regulation Best Interest.

Ms. Blass noted her expectation that the Division will recommend updates to the SEC's valuation guidance, proposals on modernizing the advertising and solicitation rules for investment advisers and a re-proposal of a rule on the use of derivatives by investment companies during 2019. She noted that the Division will also advance into the public comment process a proposal to reform business development company and closed-end fund offerings. Furthermore, Ms. Blass stated the Division plans to continue reviewing prior staff interpretive statements and guidance to identify if any should be modified, rescinded or supplemented in light of market or other developments.

*Proxy advisors*. Ms. Blass cited recent discussions regarding the proxy process and the role of proxy advisory firms as prompting an effort to update and clarify current guidance about how investment advisers should fulfill their fiduciary duties in that area. To identify possible changes, she said the Division will focus on questions such as (i) how to promote voting practices that are in the best interests of advisory clients, (ii) whether advisers are expected to vote every proxy, (iii) how advisers should evaluate recommendations of proxy advisers and (iv) how advisers should address conflicts of interest that a proxy adviser may have.

*International Policy*. Ms. Blass then discussed the Division's significant focus on international policy. With regards to monitoring the effects of foreign policy on regulated entities, Ms. Blass cited MiFID II as an example of how non-US regulation can pose significant challenges for US firms. She noted that the no-action letters issued to assist US asset managers and broker-dealers comply with MiFID II will expire in July 2020. She stated that an SEC review had determined that extending the no-action relief may be unnecessary because the market may develop solutions to this problem without further regulatory relief.

Ms. Blass also highlighted the Division's continued dialogue with the IOSCO, the FSB and their members. She stated that the Division has made working with these international organizations a priority and has sought to contribute insights from the US experience.

*Asset Management Trends in 2019*. Ms. Blass addressed long-term trends in asset management. Ms. Blass said that regulatory changes should only be made with a clear understanding of costs and benefits and with attention to unintended consequences. In this regard, Ms. Blass said that the Division plans to focus on the impact of these changes on "Main Street" investors through a new outreach initiative to small and mid-sized fund sponsors regarding regulatory barriers. She noted that the Division is also considering forming an asset management advisory committee composed of experts with diverse viewpoints to discuss issues facing the industry.

## GENERAL SESSION

***Regulatory Developments in Investment Management: Taking Stock and Looking Ahead***

**Moderator:** Susan M. Olson, General Counsel, Investment Company Institute

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

Laura J. Merianos, Principal, Vanguard

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

Ms. Olsen moderated this panel which covered certain key regulatory developments in the investment management industry over the past year, as well as emerging areas of regulatory focus, including (i) proposed Rule 12d1-4 under the 1940 Act (Fund of Funds Rule), (ii) recent amendments regarding the timing of Form N-PORT filings, (iii) efforts to recalibrate and modernize the responsibilities of fund directors and related governance requirements and (iv) various initiatives to improve and modernize fund disclosures.

*Fund of Funds Rule.* Ms. Merianos discussed the "redemption limits" under the proposed Fund of Funds Rule, which would generally restrict an acquiring fund (other than an affiliated fund of funds relying on Section 12(d)(1)(G)) that holds more than 3% of an acquired fund's outstanding voting securities from redeeming more than 3% of the acquired fund's shares in any 30-day period. She observed that the redemption limits may challenge the viability of many existing fund of funds arrangements, and questioned why the limits are needed from a policy standpoint, particularly with respect to an acquiring fund that invests in daily redeemable and liquid shares of an underlying mutual fund.

Ms. ten Siethoff stated that, in designing the proposed Fund of Funds Rule, the SEC staff's goal is to synthesize the existing patchwork of SEC regulations, exemptive orders and guidance governing fund of funds arrangements into a comprehensive and consistent rules-based regulatory framework, while continuing to protect against the potential abuses of fund of funds that Congress sought to address by enacting Section 12(d)(1). She explained that the proposed redemption limits are designed to impose an objective test to address concerns that an acquiring fund and its manager could exert undue influence over an acquired fund, including by threatening large-scale redemptions. She acknowledged that the proposed redemption limits, together with the control and voting conditions in the proposed rule, are more protective and potentially limiting than related conditions in existing exemptive orders. Ms. ten Siethoff agreed that the final rule should not unduly constrain fund of funds arrangements, which she noted have been beneficial for the industry, providing a convenient and efficient way for retirement and other investors to allocate and diversify their portfolios. She said that the SEC staff encourages industry participants to offer creative alternatives to the proposed redemption limits and other problematic aspects of the proposed rule during the comment process, keeping in mind that alternatives should preserve investor protections. Ms. ten Siethoff also noted that all existing SEC staff guidance regarding fund of funds is "fair game" for reconsideration during the comment process.

*Form N-PORT Amendments.* Ms. ten Siethoff discussed recent amendments to Rule 30b1-9 under the 1940 Act that require reports on Form N-PORT for each month in a fiscal quarter to be filed with the SEC not later than 60 days after the end of that fiscal quarter (as opposed to filing each monthly report no later than 30 days after the end of each month as required under the prior version of the rule). She noted that the report on Form N-PORT for the third month of the quarter will continue to become publicly available, and the monthly reports for the first and second months of the quarter will remain non-public. Ms. ten Siethoff noted that the amendments also require that funds, no later than 30 days after the end of each month, maintain records of the information that is required to be included in Form N-PORT, which must be made available promptly to the SEC upon request. She emphasized that the amendments in no way affect the amount or timing of the Form N-PORT information that will be made available to the public. Ms. Merianos remarked that the Form N-PORT amendments have been well-received by the industry and represent a good balance between giving the SEC access to fund portfolio holdings information in a timely manner while reducing the sensitivity of the data collected and related data security concerns.

*Responsibilities of Fund Directors.* Ms. ten Siethoff discussed two recent SEC staff no-action letters issued to the Independent Directors Council aimed at adjusting and modernizing responsibilities of fund directors, including (i) a letter providing relief from the board approval requirements with respect to affiliated transactions under Rules 10f-3, 17a-7 and 17e-1 under the 1940 Act, provided the board receives a quarterly written representation regarding compliance of the affiliated transactions from the fund's Chief Compliance Officer and (ii) a letter providing relief, under certain circumstances, from the in-person board voting requirements of the 1940 Act relating to the approval and renewal of investment advisory and principal underwriting contracts, Rule 12b-1 plans, interim advisory contracts and independent public accountants. She noted that these two letters were prompted, in part, by feedback received during the Division's Board Outreach Initiative launched early in Ms. Blass' tenure as Division Director. She stated that board responsibilities and related governance requirements will continue to be a significant focus of the Division in 2019, noting the SEC's ongoing work to update valuation guidance as an example.

*Disclosure Initiatives.* Ms. ten Siethoff noted that the Division's Investor Experience Initiative will move forward in 2019, including consideration of industry feedback on the SEC's releases requesting comment on modernizing and improving fund disclosures (issued June 5, 2018) and proposing disclosure improvements for variable annuities and variable life insurance contracts (issued October 30, 2019). Among other projects, she noted that the Division is exploring options for the use of summary shareholder reports by funds, which would represent a further step in this area following the adoption of the optional “notice and access” method for delivery of shareholder reports under new Rule 30e-3 under the 1940 Act adopted last year. The panelists expressed their views on types and methods of fund disclosures that are most useful to investors. Mr. Barbash remarked that fund disclosures should focus on answering the question “why should I invest?” and noted that most investors look to marketing materials from intermediaries and information from third-party analysts, rather than fund prospectuses, in making investment decisions. The panelists discussed the Division’s request for input on how to modernize the design, delivery and content of fund disclosures. Ms. Merianos encouraged the Division to focus on flexibility in designing improvements to disclosure regulations, such that the resulting rules are “device agnostic” and accommodate evolving technologies and means of delivery and access. Ms. ten Siethoff agreed that any resulting rule proposals should not result in “quick fixes” that become obsolete in relatively short order.

## SESSION A

***Expecting the Unexpected Cyber Event: Everything is Unprecedented Until it Happens***

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

**Speakers:** Mike Catlin, Senior Vice President, Head of Technology and Chief Information Security Officer, Capital Research & Management

Brian Contos, Chief Information Security Officer and Vice President of Technology Innovation, Verodin

Tim Hamon, Senior Forensics Examiner, Federal Bureau of Investigation

This panel explored various cybersecurity threats and how firms must assess and understand the threats they face and target their cybersecurity efforts appropriately. Mr. Hamon observed that insider cybersecurity threats generally take the form either of (i) an employee misappropriating a company’s confidential data or (ii) a disgruntled current or former employee seeking to disrupt a company’s operations. Mr. Contos noted that nation states in certain regions, especially southeast Asia, are devoting substantial resources to developing cyberattack capabilities as a method of warfare. He said that some of these nations are spending more on cyberattack capabilities than on conventional military resources. Mr. Contos observed that certain “safe harbor” countries provide a haven for cybercriminals, who face a low risk of prosecution, but potentially high rewards, for their cybercriminal activity. Mr. Hamon noted that the US has limited ability to prosecute cybercrime that is perpetrated from abroad. Some countries, he said, cooperate with the US in initiatives against cybercrime, but others are uncooperative or unresponsive to US requests for cooperation.

Mr. Hamon said that the FBI encourages collaboration with the private sector and that the FBI is eager to share certain information and best practices that might help companies improve their cybersecurity. He suggested that asset management firms appoint certain personnel to join InfraGard, an FBI-sponsored association of representatives of businesses, academic institutions, state and local law enforcement agencies and other participants dedicated to sharing information and intelligence to prevent hostile acts against the US. He noted that local InfraGard chapters operate in major cities around the US.

Mr. Catlin identified four principal categories of cybersecurity threats to commercial enterprises: (i) "hacktivists" who seek to damage a firm's brand, (ii) cybercriminals who seek to profit from the use of misappropriated data, (iii) ransomware attacks and (iv) activities by nation state actors. He provided an overview of key elements of his firm's cybersecurity program. Among other things, he noted that his firm maintains both "inner" and "outer" cybersecurity firewalls, conducts extensive testing of the effectiveness of its programs, and devotes significant efforts to reminding employees of cyber threats and good cybersecurity practices. He observed that failure to "patch" software on a timely basis is a common cybersecurity vulnerability. He emphasized the importance of constant vigilance to maintain an appropriate cybersecurity environment.

The panel discussed the importance of regularly assessing whether a company's cybersecurity products and programs are effective. Mr. Contos observed that corporate leadership and boards are increasingly focused on cybersecurity and on the effectiveness and cost-effectiveness of a company's cybersecurity unit. Mr. Catlin noted that, at his firm, the fund boards receive an annual in-person presentation regarding relevant cybersecurity matters and quarterly written cybersecurity reports.

Mr. Catlin also discussed the importance of producing playbooks for various types of potential cybersecurity crises, to prepare for an actual crisis. He said that these playbooks cover a variety of elements of the potential response to a crisis, including operational responses, internal communications, public relations and notification of law enforcement where appropriate. He noted that his company conducts periodic simulations of cybersecurity crisis scenarios and reports the results of these exercises to senior management.

The panel considered that it is not practical to protect against every conceivable cybersecurity threat at all times. Accordingly, firms must assess and understand the threats they face and target their cybersecurity efforts appropriately. Mr. Contos expressed the view that machine learning and artificial intelligence are still in their infancy as cybersecurity tools. He said that, for the foreseeable future, "traditional hygiene" and "blocking and tackling" will remain essential elements of any effective cybersecurity program. Messrs. Contos and Catlin also called attention to the shortage of skilled cybersecurity professionals in the US. Mr. Contos emphasized the importance of advance planning and employee training for possible cybersecurity events, so that relevant company personnel have an understanding of the processes that should be followed in the event of a cybersecurity crisis.

Mr. Salmon encouraged ICI member firms to participate in the ICI's annual cybersecurity survey. He said that responses are anonymous and are sorted by participating firms' assets under management, so that firms can get a sense of the cybersecurity practices of other firms of comparable size. He stated that the survey has been conducted for the past four years and results are presented on a rolling 3-year basis to facilitate the identification of trends in the responses.

Mr. Salmon noted the asset management industry's heavy reliance on third and fourth party providers for many critical services. He discussed the challenges of assessing the cybersecurity risks associated with these providers. Mr. Contos also discussed the challenges that small and mid-sized asset management firms face, given the complexity of cybersecurity threats. He also noted that cybersecurity assessment is an important part of due diligence in connection with the evaluation of potential mergers and acquisitions.

The panel concluded with an endorsement of the No More Ransom Project (nomoreransom.org), which provides information about ransomware and resources to companies that have been targeted by a ransomware attack.

## SESSION B

### *Reaping the Benefits of Equity Market Reforms for Fund Shareholders*

**Moderator:** George M. Gilbert, Assistant General Counsel, Securities Regulation, Investment Company Institute

**Speakers:** Mehmet Kinak, Vice President, Global Head of Systematic Trading and Market Structure, T. Rowe Price Investment Services, Inc.

Tara Muller, Head of Off-Exchange Liquidity, Virtu Financial LLC

Annette L. Nazareth, Partner, Davis Polk & Wardwell

This panel discussed three recent rulemakings intended to prove equity market structure by enhancing disclosures by brokers and alternative trading systems (ATSs), and by establishing a pilot program to study the effects of exchange transaction fees and rebates. The panel observed that, while today's equity markets are highly fragmented and complex, some fragmentation and complexity is inherent in creating competition among exchanges and ATSs. The panelists emphasized that the US equity market is the most robust, efficient market in the world and generally works well, although there will always be some opportunities for improvement.

The panel reviewed the order handling disclosures that will be required by Rule 606(b) of Reg. NMS beginning on May 20, 2019. The panelists noted that brokers would be required to provide institutional customers with customer-specific order handling reports with respect to "non-held" orders upon request, as well as public reports of aggregate routing information for non-held orders. The panelists stated that the volume of information available to buy-side firms will be vast, and noted that an adviser's duty to seek best execution may require it to obtain and use that information. The panel acknowledged the expectation that legal and compliance personnel would need to work closely with traders, risk managers and information technology personnel to ensure the effective use of this information. The panel discussed ways in which newly available information might require re-thinking the meaning of best execution, noting that best execution may well mean more than obtaining the national best bid or offer.

The panel discussed the disclosures required by Form ATS-N regarding the activities of the operator and its affiliates and the manner in which the ATS is operated, which are intended to permit buy-side firms evaluate conflicts of interest and information leakage. The panel explained that the information reported on Form ATS-N, which ATSs were required to file by February 8, 2019, should facilitate measurement of execution quality. The panel observed that differing practices across ATSs wouldn't necessarily indicate a problem, but acknowledged that the SEC staff would likely expect buy-side firms to exert pressure on ATSs over conflicts of interest.

The panel also discussed the transaction fee pilot program, noting that it was currently the subject of litigation brought by several stock exchanges. The exchanges have argued that the program is prejudicial because it doesn't apply to ATSs and because the SEC hasn't identified the problem that the program is intended to solve. The panel noted that the current 30 mil cap on transaction fees for removing liquidity from an exchange may be too high and has increased in relative importance as average commission rates and average spreads have declined over time. The panel also noted that rebates to providers of liquidity on an exchange may not be necessary, citing the example of the E-mini futures market.

Finally, the panel considered the problems posed by transacting in large volume in less liquid stocks, which are not addressed by the pilot program. The panel noted that SEC Chair Clayton and the director of the SEC's Division of Trading and Markets have publicly stated that the SEC staff is considering ways to improve secondary market liquidity for smaller companies.

## SESSION C

### *The Polls Are Open: Reexamining SEC Proxy Voting Requirements*

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

**Speakers:** Paul G. Cellupica, Deputy Director and Chief Counsel, Division of Investment, Management, US Securities and Exchange Commission

Sara P. Crovitz, Partner, Stradley Ronon Stevens & Young, LLP

Jill M. Forte, Senior Counsel, Thrivent Financial

Mara L. Shreck, Managing Director, Head of Regulatory Affairs—Asset and Wealth Management, J.P. Morgan Chase & Co.

This panel focused on various proxy voting-related issues, including (i) what to expect in this area from the SEC, (ii) how funds vote proxies, including their use of guidelines and proxy advisory firms and (iii) when funds make company-specific voting decisions.

*What To Expect From The SEC.* Mr. Cellupica reviewed recent actions by the SEC staff, including its September 2018 statement and withdrawal of two no-action letters and highlights of the November 2018 Roundtable. He indicated that the SEC staff was considering ways to update and add detail to existing guidance, including addressing questions such as when it might be appropriate for an adviser to abstain from voting proxies.

*How Funds Vote Proxies.* Mses. Forte and Shreck each reviewed their respective firm's approach to voting proxies. Ms. Forte discussed her firm's use of an internal committee to oversee the proxy voting process, and noted that the process strikes a balance between internal resources and external resources (*e.g.*, ISS voting recommendations). Ms. Shreck noted that her firm also utilizes an internal committee to oversee proxy voting, and discussed her firm's treatment of three different categories of voting subjects – those where the firm always voted for/against, those involving a general policy with some exceptions, and those that are always case-by-case. Ms. Crovitz discussed the role of a fund board in the proxy voting process, noting that the role was one of oversight, and that while trustees are responsible for proxy voting, in most cases, boards delegate significant responsibility to the adviser. Mr. Cellupica affirmed that a fund board's role in proxy voting is to provide oversight. He noted that the boards for certain types of funds (*e.g.*, those pursuing ESG-related strategies) tend to have a higher level of involvement, but that the SEC does not have specific requirements or expectations for fund directors beyond oversight.

*Reliance on Proxy Firms; Abstaining From Voting Proxies.* Mr. Cellupica stated that the SEC is examining possible over-reliance by advisers on proxy firms. Ms. Shreck noted that advisers must balance many competing priorities, and that some advisers may conclude it is not in their clients' best interests to vote every proxy. Ms. Crovitz observed that most advisers feel compelled to vote proxies, particularly in view of the SEC's statements that voting proxies is part of an adviser's duty of care under the Advisers Act. Mr. Cellupica noted that the SEC staff was considering whether an adviser could decide not to vote proxies with appropriate client disclosures on the subject.

In closing, Mr. Cellupica stated that the SEC staff was continuing to consider new proxy voting guidance and reminded the audience that the SEC still has an open comment file relating to its November 2018 Roundtable.

## KEYNOTE REMARKS

**Speaker:** Elad L. Roisman, Commissioner, US Securities and Exchange Commission

Commissioner Roisman discussed the SEC's review of the existing rules that govern proxy voting in his first formal remarks as a Commissioner.

*Proxy Voting.* Mr. Roisman noted that, in July 2018, SEC Chair Clayton announced that the SEC would review the rules that govern proxy voting and stated that Mr. Clayton had recently asked Mr. Roisman to lead the SEC's efforts in considering improvements to the proxy process. Mr. Roisman discussed his professional background and his belief in the fundamental importance of the proxy process to the capital markets.

Mr. Roisman noted that the SEC's November 2018 roundtable considered a number of a questions, including how fund boards and advisers are fulfilling their fiduciary duties in the context of proxy voting, how they rely on proxy advisory firms, and whether the SEC should take any actions in regard to proxy voting. Mr. Roisman said that, since the roundtable, he and his staff had reviewed the roundtable transcript, comment letters and additional literature. He also noted that he and his staff had met with participants from across the capital markets to discuss their views in greater detail.

Mr. Roisman then reviewed existing SEC rules and guidance governing fund advisers' roles in voting proxies, noting that the SEC's principles-based and disclosure-based approach to regulating this area has left a lot of flexibility for fund advisers, relying on their fiduciary duty, to fill in the gaps.

*Questions Regarding Certain Proxy Voting Practices.* Mr. Roisman identified certain practices that he hopes to understand better in the context of proxy voting. He observed that many advisers vote all proxies they receive and questioned whether advisers believe voting on all issues is material to a fund's investment objective and benefits the fund, especially in light of the costs associated with voting proxies. He invited comments regarding whether it would be helpful for the SEC to provide further guidance in this area.

Mr. Roisman also observed that some asset managers had moved toward centralizing proxy voting functions within the fund complex, moving these roles farther away from portfolio management, and that some asset managers aim to vote uniformly across funds. He expressed interest in understanding how advisers have remained cognizant of distinctions between funds when designing processes for centralizing voting and stewardship roles. He also invited comments regarding whether and how advisers have been able to develop voting policies that are flexible enough to apply to all funds, yet account for differences among them.

*Role of Proxy Advisory Firms.* Mr. Roisman discussed several questions concerning asset managers' reliance on third-party proxy advisory firms in several aspects of the proxy voting process. He observed that some asset managers appear to have adopted wholesale (*i.e.*, without customization) proxy voting policies developed by proxy advisory firms, and he invited comment regarding how asset managers become comfortable that such guidelines best serve their clients and the extent to which advisers may customize proxy guidelines. Mr. Roisman also observed that some asset managers appear to rely on proxy advisory firms to pre-populate votes in electronic proxy cards. In this regard, he invited comments regarding the amount of instruction an asset manager may provide to the proxy advisory firm and the extent to which advisers review and override the pre-populated suggestions of the proxy advisory firm.

Mr. Roisman noted that many have criticized proxy advisory firms' processes for developing recommendations as being prone to errors and suppressing viewpoints from the companies they research. He invited feedback regarding whether advisers would reassess how they use a proxy advisory firm if they learned that the firm has made a material error in its recommendation or underlying research. He also asked how advisers account for input from issuers prior to voting proxies, including issuers' reactions to what they might characterize as a proxy firm's analytical errors, and whether the SEC should explore ways of making it easier for advisers to get this information in a timely manner.

Mr. Roisman then discussed proxy advisory firms' potential conflicts of interest, noting that certain proxy advisory firms consult for public issuers on corporate governance matters. He asked whether a proxy advisor would recommend against its own consulting services when corporate governance matters of a proxy advisory firm's corporate customers are put to a vote. Mr. Roisman invited comment regarding how asset managers address proxy advisory firms' conflicts.

*Other Proxy-Related Reforms.* Mr. Roisman stated that the November 2018 roundtable shed light on how complex, inefficient and, at times, unreliable the infrastructure that underlies the proxy voting system can be. He invited feedback regarding what the SEC can do to improve the "plumbing." Mr. Roisman also commented on the thresholds for submission and resubmission of shareholder proposals. He invited feedback regarding whether the SEC should raise or modify the current monetary threshold and holding period for shareholder proposal submissions so that certain shareholders with idiosyncratic views cannot use the shareholder proposal system in a way that does not benefit the interests of the majority of long-term shareholders.

## SESSION D

***Keeping the Fox Out Of The Henhouse: How Transfer Agents Are Looking Out For Fund Shareholders***

**Moderator:** Joanne Kane, Operations and Transfer Agency, Investment Company Institute

**Speakers:** Kevin Seymour, Assistant Vice President, Global Operations Oversight, Oppenheimerfunds, Inc.
Mark C. Trenchard, Director, Operational Compliance, Putnam Investments, LLC
Elizabeth Young, Senior Anti–Money Laundering Officer, American Century Investments

This panel discussed the ways that mutual fund transfer agents are looking out for and protecting fund shareholders from fraud, exploitation and other threats to their accounts.

*Who are the Foxes?* The panel first listed the various types and people and entities that are attacking fund shareholders, including fraudsters, identity thieves and other bad actors, immediate family members, relatives and caretakers of senior investors and state actors.

*How are the Foxes Trying to Get their Hands on Shareholders' Accounts and Assets?* The panel discussed how fund investors are being targeted. They discussed account takeovers and other fraudulent attempts to steal account assets, such as through the use of counterfeit checks, creating synthetic IDs, stealing log-in credentials, using social engineering (including through a combination of phone and on-line communications), financial exploitation of senior citizens and state escheatment laws that deem accounts abandoned to seize assets. The panel shared key statistics on fraud, including that 64% of transfer agents have reported an increase in fraudulent activity/attempts during the last 12 months and that more than half of these attempts generally pass current phone or web authentication protocols. They also noted that there has been an increase in account takeovers by unknown third parties, fraudsters are more patient and persistent than they used to be, and fraudulent activity is not limited to one specific account type or age group, although the activity does have a larger impact on shareholders that are 41 and older. The panel also noted that, as a general matter, internal controls are identifying a majority of fraud attempts. The panel observed, however, that where client-facing personnel are given discretion to provide out-of-the-norm individual customer service that creates exceptions to policies and procedures, there is a higher risk of fraud being successful or going undetected.

As part of the discussion regarding older investors, the panel noted that financial fraud targeting seniors cost an estimated $2.9 billion annually and that US banks reported a record 24,454 suspected cases of elder financial abuse in 2018. Although people over 50 only represent one-third of the population, they account for 61% of bank accounts and 70% of deposits. Finally, the panel noted that approximately 100 million individual investors and 56.2 million (44.5%) households own mutual funds, with the median age of the head of household being 51.

*What Are Fund Transfer Agents Doing to Protect Shareholders?* The panel discussed what transfer agents are doing to protect fund shareholders. The panel discussed the use of the ICI's Transfer Agent Advisory Committee and Fraud Prevention Working Group and the frequency and value of transfer agents sharing experiences and potential responses with other transfer agents. The panel discussed individual transfer agent protection efforts, emphasizing the importance of properly trained front-line staff, robust escalation requirements, back-end reports, technological solutions and other controls. Panelists noted the importance of technology in being able to effectively research potential fraud, but noted that special technology continues to be costly. With regard to senior shareholders, the panel discussed the recent no-action relief provided by the SEC staff permitting delayed delivery of redemption proceeds when fraud is suspected. They also noted special education programs for senior investors relating to exploitation and financial fraud, special monitoring with respect to senior investors and specific front-line personnel training to identify senior exploitation. The panelists noted that not all fund complexes have relied on the SEC no-action relief to date.

With regard to fund controls, the panel noted that funds should have most of their controls triggered pre-redemption, as opposed to post-redemption, noting a fund's limited ability to retrieve redemption proceeds post-payment. With regard to particular controls, the panel noted the need for processes that recognize how "good guys" and "'bad guys" access accounts, recognizing "out of wallet" questions, dual factor authentication, duplicate hard copy confirmation to the shareholder's address and the use of waiting periods. The panel noted that client service real time alert notification systems continue to be quite expensive. The panel also noted the use of medallion guarantees, and that at least some fund complexes do not permit redemptions or new account openings on the web. The panel noted the need to have controls with regard to broker-dealers as they can be compromised, as well.

With regard to responding to a fraud event, the panelists discussed their policies of notifying law enforcement (both local and federal) depending on the event, and the importance of having relationships with law enforcement.

The panel finally discussed state escheatment issues, including the evolution of state escheatment efforts by states. The panel noted the use of contingent fee auditors, and the need for shareholder account monitoring for potential escheatment and the strain on resources to do such monitoring. The panelists also acknowledged the benefit of shareholder outreach efforts and the value of the ICI's Abandoned Property Working Group.

## SESSION E

***Changing Environment: Implications for Fund Boards***

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

**Speakers:** Rajib Chanda, Partner, Simpson Thacher & Bartlett LLP

Patricia Louie, Independent Director, Oakmark Funds

Paulita A. Pike, Partner, Ropes & Gray LLP

This panel explored several topics of interest to fund boards, including compliance matters, board materials, liquidity risk management and oversight of conflicts of interest.

*Boards, Compliance and the CCO.* The panel began with a review of board actions in response to the no-action letter issued by the SEC last fall, which permits fund boards to rely on a representation from the fund CCO when reviewing certain types of transactions permitted by exemptive rules. Specifically, the no-action letter relieves boards from having to approve transactions permitted under Rule 10f–3 (transactions involving affiliated underwriters), Rule 17a–7 (cross trades between funds in the same complex) and Rule 17e–1 (transactions involving an affiliated broker-dealer). Instead, boards can rely on the CCO's review of those transactions and a representation from the CCO indicating that those transactions have been effected in compliance with the rules. Ms. Louie noted that, while the no-action letter has provided welcome relief by decreasing some of the workload that her board undertakes and reducing the materials that her board receives, it has not eliminated the board's review of those transactions altogether. Ms. Pike and Mr. Chanda noted that their clients continue to receive various forms of back-up materials, including summaries of the diligence undertaken by the CCO to reach his or her conclusions, as well as trend analysis that shows the number and nature of transactions. Ms. Pike noted that, while boards can rely on their CCO, that reliance ought to be "reasonable" and based on materials that enable a board to reasonably rely on the CCO.

The panel discussed current practices relating to board reliance on the CCO. They observed that, while it is important to recognize that CCOs are not a panacea for everything that requires oversight, CCOs may be better positioned than a fund board to assume certain types of oversight responsibilities. Ms. Pike noted that CCOs are adept at communicating to boards when certain responsibilities (for example, cybersecurity) are not particularly in their bailiwick. As a result, she explained that CCOs tend to be effective at protecting themselves from taking on more than they can handle or taking on work that is not compliance-focused.

*Board Materials.* Ms. Lancellotta stated that independent directors continue to discuss the growing volume of board meeting materials and how to develop and organize materials to allow a board to operate as effectively as possible. Ms. Louie noted that the board on which she sits is constantly evaluating how to "think thin," using exhibit and resource books where appropriate, and summarizing materials in "cheat sheets" where possible. Ms. Pike cautioned that no matter where materials for a meeting are posted (whether in the board book or in a separate exhibit book), they remain part of the official record of the meeting. As such, she advised that it is prudent to ask for summaries of lengthy materials and to be sure that, even when materials are in an exhibit book, directors understand them.

In response to questions about directors' use of personal e-mail accounts for fund business and personal devices to review board materials, Ms. Pike cautioned that the devices and e-mail accounts used by directors are often the subject of subpoenas. With respect to iPads, she said that the iPad may need to be turned over to a plaintiffs' attorney and that anything on the iPad could be used against a director. Similarly, she noted that personal e-mail accounts often have to be shut down in connection with subpoena responses. In response to questions about notetaking in electronic board books, Mr. Chanda stated that the safest approach is for directors to take notes on paper. Ms. Pike warned that it is difficult to know if a note taken on an electronic device is ever truly "gone."

*Overseeing Conflicts of Interest.* Mr. Chanda described the SEC's continued focus on the conflicts presented when an asset management firm offers the same or similar strategies in different types of vehicles (such as registered funds, hedge funds, separate accounts, etc.). He noted that, because this type of side-by-side management involves potential conflicts of interest relating to the allocation of investment opportunities and the fees charged for managing those products, it is prudent for a board to understand what (if any) side-by-side management the fund investment adviser is engaged in and to explore how conflicts are being addressed. Ms. Pike added that conflicts also could exist with respect to the allocation of resources. For example, she explained that it would be important for a board to understand how much time a fund portfolio manager is spending managing non-fund assets, whether the portfolio manager's compensation is tied more heavily to the performance of the fund(s) he or she manages or other products the portfolio manager may be managing, and whether the right incentives exist to ensure that investment personnel are paying at least as much attention to the funds as they are to other products.

The panel also considered prevalent industry trends, including the flow of assets from actively managed to passively managed products, decreasing profit margins, consolidation and diversification of product types. Mr. Chanda stated that understanding how these trends may affect a fund manager is important because it will help the board understand the dynamics influencing proposals that the board may be asked to consider. He also remarked that understanding the manager's pressure points will make the board more effective in negotiating outcomes for investors. Ms. Pike noted that that board and management conversations about other product types are important because they enable a board to discern whether appropriate resources are being dedicated to the funds they oversee, how the launch of non-registered products may affect the fund complex and how the adviser's diversification of product offerings could impact seed funding for new funds.

*Liquidity Risk Management.* Ms. Pike reviewed the status of efforts underway by managers and boards to comply with all aspects of the liquidity rule by June 1, 2019. She stated that most of the asset management firms with which she works are either testing or have almost finished testing the systems and protocols that will aid in the bucketing of portfolio holdings into one of the four required categories. Ms. Pike indicated that, in connection with their consideration and approval of a liquidity risk management program, boards have received presentations highlighting how the securities of each fund overseen by the board will be bucketed, how the bucketing will look by asset class in the fund group, which funds in a complex would likely require the designation of a Highly Liquid Investment Minimum (HLIM), how the manager will interact with the vendor (if one is being used) that will provide bucketing information and how manager-of-manager complexes will interact with subadvisers. As to this last topic, Ms. Pike explained that it is possible that different subadvisers (or a subadviser and a manager) might reach a different bucketing conclusions for the same security, and that is important for managers to have considered this possibility ahead of time. Similarly, she stated that it is important for boards to understand how the manager will work through this scenario.

Finally, Ms. Pike said that boards are currently considering how their periodic liquidity risk management reports are likely to be organized. She explained that one potential strategy is to use a "focus funds" report, which highlights funds that are less liquid, have a designated HLIM, and are about to be launched or were recently launched, among other potential attributes.

## SESSION F

***Ebb or Flow? Finalizing Liquidity Programs***

**Moderator:** Matt Thornton, Investment Company Institute

**Speakers:** Lance C. Dial, Managing Director and Counsel, Wellington Management Company, LLP

Randall S. Fillmore, Chief Compliance Officer, Aquila Investment Management LLC

Tilak Lal, Vice President, Performance Analysis and Investment Risk, Franklin Templeton Investments

Mr. Fillmore began the panel discussion by sharing the perspective of a sponsor of a small fund complex. He explained that the Aquila fund complex offers funds of relatively small asset size, some of which invest significantly in municipal bonds that do not trade frequently. He explained that his fund complex did not have the resources to build its own classification model and instead worked with a third-party vendor. Mr. Fillmore described some of the challenges that arose from working with a third-party vendor. He noted, for example, that the vendor had difficulty building models for municipal bonds, some of which trade infrequently, and that the vendor originally intended to treat as less liquid or illiquid certain instruments that, in Aquila's experience, were highly liquid, such as certain pre-funded bonds. He discussed the measures Aquila had taken to demonstrate to the vendor the liquidity of those bonds and to cause the vendor to revise its approach. Mr. Fillmore also explained how the new Rule 22e-4 liquidity risk management program differs from Aquila's existing liquidity risk management program, which relies significantly on subjective portfolio-manager-based assessments of liquidity.

Mr. Dial then discussed challenges his firm had faced in implementing its liquidity risk management program. He described the challenges of building a CUSIP-specific program that also incorporated fund-specific criteria and information. He explained the process his firm had undertaken to ensure its program incorporated all of the significant market data relevant to the assessment of liquidity. Mr. Dial and Mr. Lal noted that, like Mr. Fillmore's firm, the number and backgrounds of the individuals involved in the administration of their firms' liquidity risk management programs had increased significantly with the adoption of Rule 22e-4. Mr. Lal noted that his firm's program includes daily compliance alerts sent to a fund's portfolio management team, requires that portfolio managers review vendor classifications periodically, and gives those managers the ability to challenge a vendor classification by working through the firm's liquidity risk management committee.

Mr. Dial described the challenges Wellington faced as a sub-adviser to funds sponsored by many different and unrelated fund sponsors. He explained that it would have been impractical to apply all of the different liquidity risk management programs of those sponsors, and that Wellington has designed a single program to monitor its clients' compliance with Rule 22e-4. He added that that program will permit Wellington's sub-advisory clients to set certain elements of their funds' program, such as each fund's reasonably anticipated trading size and, where applicable, highly liquid investment minimum. He also described implementation-related challenges that Wellington was currently addressing, including assessing how its liquidity risk management program may affect management of its sub-advisory client portfolios, incorporating its liquidity risk management program into its compliance monitoring and trading systems, and finding ways to share the results of the program with its sub-advisory clients through information sharing and reporting. Mr. Dial stated that Wellington continues to build out its systems to give its sub-advisory clients the ability to monitor and to assess the data Wellington is using and the resulting classifications.

A discussion among the panel members followed regarding the practical challenges associated with assessing the effects of holidays in local markets on the liquidity of foreign securities that only trade in a local foreign market. During the discussion, one panelist stated that he understood certain registrants were applying the term "business day" to refer to the business days in the relevant local market for a foreign holding rather than a fund business day, and he noted that were was at least some support for that position in the adopting release for Rule 22e-4. Another panelist noted that he understood other registrants were applying references to business days within Rule 22e-4 to mean only business days for the relevant fund.

The panel also discussed funds that invest principally in bank loans. The panelists noted that the long settlement terms of the investments necessarily meant that such funds would have a significant portion of their assets classified as less liquid investments. They noted that such funds require careful consideration of their highly liquid investment minimums, including in light of non-portfolio sources of liquidity for the funds.

Mr. Fillmore then commented on the difficulty in assessing whether a fund could sell an investment in amounts it reasonably anticipated trading without the sale (or conversion to cash) significantly changing the market value of the investment, as required by Rule 22e-4. He noted that the SEC had changed the standard at issue from "materially" to "significantly" to provide funds greater flexibility. He stated his view that most fund complexes are still adopting a relatively conservative standard in this regard, noting that he understood the majority of registrants were using a 1% price change threshold, with others using anywhere from 2% to 5%, depending on the asset class involved.

Mr. Lal commented on the complexities associated with trying to quantify the amount of assets segregated or pledged with respect to derivative instruments classified as other than highly liquid investments. He noted the complexity posed by multiple trades for a fund, some of which may be highly liquid, across a single ISDA and the netting of collateral posting obligations. He stated that his firm has made a number of conservative assumptions that will likely have the effect of overstating the amount of assets reported as pledged or segregated against non-highly liquid investments, but that those assumptions simplified the problem to one that was tractable.

Mr. Fillmore discussed how to assess a fund's reasonably anticipated trading size. He stated that his firm's approach factored in both a fund's shareholder ownership concentration and its past redemption activity. He stated that his firm would also apply stressed redemption scenarios as part of its assessments, using a reasonably anticipated trading size that is double the fund's worst redemption levels over the prior ten years.

The panel then discussed reporting to a fund's board of trustees. During that discussion, Mr. Fillmore explained that his firm intended to provide its board with trend analysis reports and listings of each illiquid investment and that this information would supplement the reporting already required under Rule 22e-4.

During a panel discussion regarding the longer-term effects of Rule 22e-4, the panelists posited that the rule has been helpful in focusing the industry on liquidity risk management and serving as an impetus to the rapid development of new liquidity tools and a new liquidity risk management support industry. Mr. Lal noted that the liquidity rule's requirement to consider the cash needs of funds, including by incorporating reasonably anticipated trading size, reflects a more holistic approach to risk management than has historically been used by many managers. In this regard, Mr. Lal stated that he hopes portfolio managers will come to embrace the results of the liquidity risk management program, including with respect to risk budgeting, and not simply view it as a compliance function.

Mr. Dial expressed concern regarding the public disclosure of liquidity classifications, including how that information might be misconstrued. In particular, he warned that investors may not realize that firms can take different approaches to the liquidity classification requirements and that investors may believe there are greater differences among funds' liquidity than actually exist. Mr. Fillmore stated that he hopes the liquidity rule has the effect of improving discussions with boards regarding liquidity risk management issues and increases liquidity risk transparency overall. He also noted that he hopes that fund industry participants will share information regarding best practices broadly among other industry participants, and that the SEC staff revisits the costs and benefits of the liquidity rule and makes changes to the liquidity rule, where appropriate.

## GENERAL SESSION

### *The SEC's Focus on Investor Protection: RICs on The Radar of OCIE and Enforcement*

**Moderator:** Christopher Michailoff, Senior Director and Associate General Counsel, TIAA

**Speakers:** Stephanie Avakian, Co-Director, Division of Enforcement, US Securities and Exchange Commission

Julie M. Riewe, Partner, Debevoise & Plimpton LLP

Kristin Snyder, Deputy Director, Office of Compliance Inspections and Examinations

This panel focused on inspection and enforcement trends at the SEC.

*OCIE's Examination Priorities.* Ms. Snyder noted that the examination priorities of Office of Compliance Inspections and Examinations (OCIE) are developed based on an assessment of the standard risks faced by registrants, as well as feedback from the SEC examination staff in the field. She stated that the SEC sometimes includes an item on its priorities list because it wants to gather information that could be useful in informing policy. She noted that policy is also informed by OCIE's engagement with fund boards and senior management outside of the context of examinations.

Ms. Snyder provided the following feedback about issues being considered in connection with certain OCIE priorities: (i) ETFs with little secondary market trading volume – the issues being considered are whether firms are addressing the risks associated with low trading volume, such as widening spreads, potential delisting, and potential liquidation, whether tracking error is being monitored, whether the board is receiving information to allow it to oversee appropriately the risks associated with low trading volume, and whether there is appropriate risk disclosure, (ii) funds with aberrational underperformance relative to their peer groups – the focus will be on funds that have performance that is several standard deviations below peer performance over multiple periods, and issues being considered are why the fund is underperforming and whether its underperformance gives rise to risks, such as excessive fees or trading issues, and (iii) cybersecurity – the focus will be on firms with large branch office networks or where there has been merger and acquisition activity. In addition, while the use of quantitative models is not an identified examination priority, Ms. Snyder stated that the SEC staff is looking for good "hygiene" around the use of models, including how a model is tested, both initially and when changes are made to the model, whether it is performing as expected, whether there is appropriate disclosure if issues are identified, and whether the board is overseeing the compliance program built around the model.

Ms. Snyder stated that she expects that OCIE will continue with its more targeted approach to examinations. She also commented that the shutdown did not result in any changes to OCIE's priorities, but that there may be fewer examinations this year.

*CCO Liability.* Ms. Avakian stated that there has been no change in how the SEC staff thinks about CCO liability, noting that there are two categories of activity that are more likely to give rise to CCO liability: (i) when the CCO is involved in the underlying securities law violation (Ms. Avakian noted that the SEC staff observes that this occurs more often when the CCO is wearing multiple hats) and (ii) when the CCO failed to carry out her responsibility to implement compliance policies and procedures. She said the SEC staff acts when the CCO does not perform her duties, but does not second guess a CCO's professional judgments.

*Resolution of Exams and Investigations.* Ms. Riewe commented that OCIE's language in letters provided to registrants following an examination seems to have a more aggressive tone of late, and suggested that the SEC staff should be sensitive to how that tone is perceived given that these letters frequently need to be shared with clients. Ms. Avakian stated that the industry should be able to understand why enforcement cases have been brought, noting that cases may be brought even for technical violations that have not given rise to investor harm or fraud, especially in higher risk areas, such as custody or affiliated-party transactions. Ms. Snyder commented that OCIE wants the industry to be aware of its findings, which is why it issues risk alerts periodically. She noted, however, that it is a lengthy process to issue a risk alert after an examination initiative is completed.

## SESSION G

***Advertising in the Digital Age***

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

**Speakers:** Michael S. Caccese, Management Committee Chairman, Practice Area Leader Financial Services, K&L Gates

Danielle Nicholson Smith, Senior Legal Counsel, T. Rowe Price

Kamala C. Sachidanandan, Global Head, Core Compliance, Invesco

This panel discussed the application of advertising rules and guidance developed in the age of static media to today's increasingly interactive digital media.

Mr. Caccese reviewed FINRA Rule 2210, related FINRA guidance and other rules (such as Rules 482 and 34b-1) that apply to advertisements. He said that complying with recordkeeping and review and approval requirements was a particular challenge when advertising via social media. He said that it was necessary to apply old rules to new media by analogy: a website is like paper; a blog is like a press conference. He then commented on the doctrines of entanglement and adoption. He said that a website link to third-party content, with appropriate disclaimers, probably did not constitute adoption of the third-party content, but that commenting on the third-party content probably did. He said that revising a wiki page was an example of entanglement.

Mr. Caccese predicted that the SEC would develop new rules and guidance, updating existing advertising guidance for the current digital, interactive media world. He also predicted that the SEC would distinguish between institutional and retail advertising, providing meaningful flexibility in institutional advertising (even to the extent of allowing the use of past specific recommendations), but would take a conservative approach towards retail advertising. He said that the SEC would confront the use of back-tested performance, and would also address advertising through social media.

Ms. Smith said that she would like to see past specific recommendations permitted, and would like to see rules specifically addressing digital media so that it would no longer be necessary to draw analogies to paper advertising.

Ms. Sachidanandan said that she would like to see SEC and FINRA advertising rules harmonized, so that investment advisers and broker-dealers were treated in the same manner. She said that she would also like to see guidance addressing interactive advertising, and the required proximity and prominence of disclaimers in digital and interactive media. As an example, she discussed expand/collapse features in digital media, suggesting that, if the look and feel of the feature was such that a user would recognize that it was important, expand the disclosure, and view the disclosure, then it should satisfy prominence and proximity requirements. She said that, when developing digital advertising and assessing its compliance with existing regulations, it was important to collaborate closely with the business (and regulators) to understand how the technology delivering the advertising works (which is necessary to develop assurance that there is appropriate recordkeeping), and to know how employees are using the technology.

The panelists agreed that, because of the lack of clear, specific rules addressing social media advertising, principles-based training was critical. Ms. Smith commented on training intended to allow associates at T. Rowe Price to identify and interact with material on the company's website, and use LinkedIn in connection with their jobs. As an example, she said that training on the testimonial rule was necessary, so that associates would understand the implications of "liking" something. The panelists also agreed that ongoing training was necessary, not only to reinforce concepts but to address the constantly changing nature of social and digital media. Ms. Sachidanandan said that Invesco used trending compliance exceptions to focus future training. She commented on the global nature of Invesco's business and on the desirability of having a consistent, global approach to compliance in this area. She said that this approach requires collaboration across the organization, and an organizational structure that facilitates collaboration.

Ms. Smith reviewed the regulations relevant to “robo” advice, covering FINRA guidance in the areas of research and due diligence (to ensure that the investment process is fair), suitability and client profiling (to ensure that clients are receiving appropriately tailored investment advice), and the sufficiency of algorithms used to identify risk tolerance and provide an appropriate investment model. She then reviewed recent SEC staff guidance in this area, which also addressed disclosure obligations (descriptions of the adviser, the advice, and for whom the advice is intended).

Ms. Sachidanandan described Invesco’s development of a “chatbot,” intended to answer questions about Invesco and its products. She reviewed the challenges, including addressing the risk of cherry picking. She said that the chatbot was developed using the “logic” of Invesco’s website as a guide to structuring the chatbot’s questions and answers. She said that Invesco developed a large matrix of questions and responses (including an indication as to what was intended by each response), which Invesco allowed FINRA to beta test. She said that the relationship with FINRA was open and cooperative. She commented on the importance of monitoring the chatbot; because the chatbot was capable of learning from its interactions with users, which might cause it to learn the wrong things (and thus provide inappropriate disclosure responses). She said that the chatbot matrix was presumably analyzed under advertising regulations as if it were a blog.

Mr. Caccese commented on upcoming changes to GIPS (voluntary standards for calculating and publishing investment performance administered by the CFA Institute), noting that GIPS 2020 was expected to be adopted later in 2019 and become effective on January 1, 2020. He said that the proposed GIPS 2020 standards distinguished between broadly distributed pools and limited distribution pools, and that it was currently unclear which category applied to institutional share classes of registered investment companies.

Looking five years into the future, the panelists stated that they expected that digital media would have evolved in ways that are now hard to predict. They expressed hope that there would be clear regulatory guidance, that inconsistencies in existing guidance will be reconciled, and that essentially the same rules will apply to all products across all media.

## SESSION H

### *Having Your British Cake and Eating Your European One Too – New Operational and Investment Challenges*

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

**Speakers:** Jean-Marc Goy, Senior Counsel, Capital Group

Heidi W. Hardin, Executive Vice President and General Counsel, MFS Investment Management

Jaime A. Madell, Director, Legal Counsel, Guggenheim Partners Investment Management, LLC

*MiFID II.* Ms. Hardin addressed the principal issues under MiFID II that investment managers are currently struggling with. She discussed the required reporting of transaction costs, noting that the regulations require detailed reporting on “implicit transaction costs," but do not prescribe a specific methodology for calculating them. In the absence of guidance, she said that firms are developing their own approaches to the calculation, which will lead to significant inconsistencies across regulated firms. Ms. Hardin then discussed the requirement for monthly reporting of actual management fee costs to clients. She stated that most firms, such as MFS, provide quarterly reports to clients, and are trying to establish what a monthly report would encompass. Ms. Hardin commented on enhanced transparency around trading, noting that while the sources of liquidity have shifted from a market structure perspective, MFS has not seen a reduction in the availability of liquidity. She also discussed transaction reporting, which must be done on a T+1 basis. Ms. Hardin pointed to the approximately 300 pages of regulations on this topic. Given the large amount of data involved, the highly technical nature of the reporting requirements, and the fact that firms will be responsible for even the smallest of errors, Ms. Hardin noted that compliance here will be costly and time-consuming.

Ms. Hardin then turned to the unbundling of execution and research costs under MiFID II. She stated that investment managers are taking differing approaches to the new regulations. Some, like MFS and Capital Group, are paying hard dollars for research out of their own resources. She stated that the principal rationale for this approach is the desire to treat all clients, wherever located geographically, the same in regards to execution and research costs. She acknowledged that firms are taking different approaches to the topic, and that there are operational challenges to paying for research where the provider cannot accept direct cash payment from the investment manager. Ms. Hardin pointed to industry data suggesting a 20-30% drop in research budgets as a result of MiFID II. She also noted industry concerns about a drop in the quality of research, although she said that MFS has not seen evidence of that from its top research providers. Finally, Ms. Hardin noted that she expects increased global regulation on this topic.

*LIBOR Transition*. Mr. Madell turned to the topic of the transition from LIBOR to other floating rate interest rate measures. He stated that, as a result of the LIBOR scandal of 2012, LIBOR will cease to exist as a reference rate in 2021. He said that, given the extensive use of LIBOR in loan agreements, futures and swap documentation, firms will need to figure out a way to transition from LIBOR to a new reference rate for any transactions that extend beyond the end of 2020. Mr. Madell noted that viable alternative rates are not fully developed, and that firms will need to be patient as this process unfolds. In the meantime, however, he recommended that firms do a thorough inventory of all of their documentation that includes references to LIBOR, so that when market solutions come into view, they will be in a position to move quickly to amend the documentation. Mr. Madell stated that firms will continue to have to use LIBOR in new documentation, but urged that they should preserve maximum flexibility in these documents to effect a change in the reference rate when the time is right. He cautioned firms to be mindful of so-called "basis risk", that there may be differences between the rates used in hedging instruments and those in the instruments for which the hedge is being applied.

*Brexit.* Mr. Goy noted the current turmoil in the UK relating to Brexit and that given the uncertainty, investment firms need to plan for various contingencies, which could include a hard exit or one involving an orderly transition. He stated that Luxembourg expects an influx of over 3,000 new jobs resulting from the relocation of certain operations from the UK. Ms. Hardin noted that MFS is making use of its Luxembourg operations for this purpose. The panelists expressed concerns about the status of UK citizens who are working in the EU and what their status will be post-Brexit. Mr. Goy stated that the news is not all bad, as the EU and the UK recently made reached an agreement with respect to delegation arrangements.

Mr. Goy noted ongoing discussion in the industry regarding reform of the EU regulatory structure. He stated his strong belief that a major overhaul is not needed, and that the regulatory scheme is working effectively.

## SESSION I

### *Award For Best New (W)rapper: Choosing the Right Alternative Fund Structure for Your Next Launch*

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

**Speaker:** Randy Anderson, President, Griffin Capital Asset Management Company, LLC

Allison Fumai, Partner, Dechert LLP

Joshua D. Ratner, Executive Vice President and Deputy General Counsel, Pacific Investment Management Company LLC, Chief Legal Officer of PIMCO Funds

Charles Upchurch, Director, Wealth Management Services and Clearing, TD Ameritrade

This panel discussed certain alternative fund structures, including interval funds, tender offer funds, listed closed-end funds with unique features, business development companies (BDCs), exchange-traded managed funds (ETMFs), and actively-managed semi-transparent exchange-traded funds (actively-managed semi-transparent ETFs).

*Interval Funds and Tender Offer Funds.* Ms. Fumai described the key features of interval funds and tender offer funds. She explained that interval funds are publicly-offered, non-exchange traded closed-end funds required by law to make periodic offers for repurchase of their shares. She stated that, pursuant to Rule 23c-3 under the 1940 Act, these funds were required to offer to repurchase between 5%-25% of their outstanding shares at intervals of either three, six, or twelve months and were subject to certain liquidity requirements during the repurchase period.

Ms. Fumai explained that tender offer funds are similar to interval funds in that they are also a type of non-exchange traded closed-end fund that offer periodic liquidity through repurchases. She noted, however, that tender offer funds provide more flexibility than interval funds in that the funds are not required to conduct tender offers at any particular time or for any particular amount, nor are they required to maintain a certain amount of liquidity during the term of the offer. Practically speaking, however, tender offer funds typically set regular tender schedules and must have some liquid assets on hand in order to pay tendering shareholders.

Mr. Anderson commented on the types of strategies that work well in an interval fund or tender offer fund wrapper. He stated that these types of funds often make sense for less liquid strategies that focus on real estate, credit, and other sectors with public and private opportunities. He emphasized that managers should select a particular fund structure based on the proposed strategy and should manage the fund in a way that provides investors with clear liquidity expectations.

Mr. Fang noted that interval funds and tender offer funds have gained significant traction in the market over the last ten years, with interval funds becoming increasingly popular in the past few years. Ms. Fumai discussed potential reasons for the growth in interval funds, including (i) the recent slowdown in underwritten IPOs for listed closed-end funds, (ii) the fact that the structure is relatively easy to understand, but can accommodate complex strategies, (iii) the flexibility for distribution opportunities (including potential use of point and click sales), and (iv) the appeal of closed-end funds for certain asset classes in light of the new liquidity rule.

Mr. Anderson then commented on the potential challenges involved in launching an interval fund. He stated that managers need a good understanding of how to market these funds, how to distribute them, how to grow them to scale, and how to withstand market cycles. He discussed the importance of performance in a daily priced environment and the need for robust policies and procedures around the valuation of illiquid assets. Mr. Upchurch emphasized on the importance of ensuring that investors understand the redemption process. He noted that an ICI sub-committee, the Broker-Dealer Advisory Committee, was advocating for ways to automate the redemption process for a smoother investor experience.

*Listed Closed-End Funds with Unique Features.* Mr. Ratner commented on the market for traditional closed-end funds, noting the recent decrease in the number and size of closed-end funds launched and the fact that some funds have been trading at a significant discount. He stated that, in a traditional closed-end fund IPO, investors typically bear offering costs and pay a sales load of around 4%. He said that, in light of this initial outlay, investors are disappointed when funds trade at a discount shortly after the IPO, which results in a challenging environment for underwriters. As such, he said that some managers have sought to bolster interest in closed-end fund offerings through unique terms.

Mr. Ratner commented on a recent successful PIMCO closed-end fund offering, highlighting two innovative features: the fund's limited term and fee structure. He explained that, instead of a perpetual term, the fund had a twelve-year term. At the end of the twelve-year term, the board of trustees of the fund could decide to either extend the term for another 18 months or conduct a tender offer for all the outstanding common shares of the fund. If enough of the fund survives after the tender offer, the fund could continue perpetually. If not, the fund would liquidate in the ordinary course. Mr. Ratner further explained that, with respect to fees, in order to alleviate investors' and underwriters' fee concerns, PIMCO picked up the offering costs, underwriter structuring fees, and commissions paid to financial advisors.

*BDCs.* Ms. Fumai described the principal characteristics of BDCs. She stated that BDCs must invest at least 70% of their assets in certain types of assets, most notably, US private and small public companies. She stated that BDCs offer more leverage than traditional closed-end funds and have looser affiliated transactions rules. Mr. Anderson further discussed the 70% bucket for qualifying assets and noted the need for managers of BDCs to manage both the 70% and 30% buckets in order to continue to access capital markets when spreads are tight.

*ETMFs and Actively-Managed Semi-Transparent ETFs.* Ms. Fumai described the features of ETMFs and actively-managed semi-transparent ETFs, which are products similar to ETFs but, unlike ETFs, are not required to report their full portfolio holdings on a daily basis. She explained that ETMFs trade creation units and are listed and traded on the secondary market at values linked to the fund's next daily NAV. She stated that actively-managed semi-transparent ETFs, which have not yet been authorized by the SEC, would be priced more like traditional ETFs. She described the two ways these products are expected to be structured, using either the blind trust model or the proxy basket model, and noted that exemptive applications that would permit these structures are pending with the SEC.

## SESSION J

### *Effective Data Use: A Differentiator in Asset Management?*

**Moderator:** Marty Burns, Chief Industry Operations Officer, Investment Company Institute

**Speakers:** Michael P. Carr, Principal, The Vanguard Group

Lee Davidson, Head of Quantitative Research, Morningstar, Inc.

Christine P. Waldron, Senior Vice President and Chief Global Strategy Officer, US Bank Global Fund Services

The panel began by discussing the effective use of data in the asset management industry. Mr. Burns suggested that data can be a major differentiator among asset management firms – it can be used not only to increase efficiency, but to enhance the client experience. He stated that firms face three challenges in effective data use: (i) the impact on investing vs. investors, (ii) the bridge between analytics and artificial intelligence (AI) and (iii) engagement with and oversight of third parties.

Mr. Carr began by noting that all data scientists have a voracious appetite for information. He stated that it is this pursuit of information that feeds into higher-end analytics. He noted that, oftentimes, firms don't have a sense of what data will be useful to them until after they begin using said data. Mr. Carr stated that most firms use a cloud provider to capture and assess information that might be useful to their business. He cautioned that one of the challenges of effective data governance with respect to cloud usage is for firms to keep the information technology (IT) folks aware of how the data is being used and by whom. Mr. Carr noted that it is important to develop an enterprise data governance program and appoint a chief data officer to establish controls in the cloud.

Mr. Davidson noted that the importance of distinguishing between how data will be used for investors as opposed to investments, noting that the former may raise concerns with respect to personally identifiable information. He stated that, if possible, it's best to keep these data categories anonymous in the cloud and deconstruct them downstream within the asset management organization.

Ms. Waldron then commented on data governance from the service provider (third-party) point of view. She noted the importance of asset management firms working effectively with their custodian, transfer agent and administrator so that the service providers understand the asset management firm's data governance protocols. She noted that this is challenging for small asset management firms that might not have a dedicated chief technology officer. For that reason, she continued, it is even more important for small firms to coordinate with their service providers.

The panelists then discussed AI. Mr. Davidson noted that an effective AI platform should have three components: (i) domain expertise (from analysts), (ii) an established system to obtain data and (iii) general machine learning models. Mr. Davidson emphasized that before one uses a model to predict the future, one should be sure the model can predict the past. Mr. Carr and Ms. Waldron agreed with the need to back-test models on a regular basis, and noted the importance of an audit trail back-testing. In response to a question regarding the role of compliance departments with respect to data analytics, the panelists noted that regulators are making heavy use of analytics as part of the exam process and further noted that compliance departments typically want to be able to use the same analytics as the regulators. The panelists agreed that in-house compliance teams should work closely with their IT departments in this regard.

The panelists next discussed how asset management firms staff the teams responsible for identifying the AI capabilities that would be useful to a firm. Mr. Davidson noted that the need to go beyond the data scientists and look for as many generalists as possible. He noted that successful teams often consist of individuals with computer science, engineering, finance, and operational backgrounds. He also noted that such teams can benefit from bringing legal and compliance representatives into these projects at the early stages. Ms. Waldron noted that it is also important to have representatives of a firm's custodian, transfer agent and administrator as part of the team.

In conclusion, the panelists discussed their views as to what the critical touchpoints are likely to be regarding the use of data in the asset management industry over the next few years. Mr. Carr stated his belief that demand for enhanced analytics will intensify, with noticeable impact on compliance teams. He further stated that he believes AI will be a more prominent tool. Mr. Davidson concurred with Mr. Carr, noting that he believes there will be a meaningful uptick in data governance rules and regulations. Ms. Waldron stated that data services are viewed today as an asset in the third-party provider space, but suggested that such services will become the norm rather than the exception.

## SESSION K

***Mutual Fund Civil Litigation: The Year in Review***

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

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

James O. Fleckner, Partner, Goodwin Procter LLP

Jennifer G. Lepentis, Senior Vice President and Associate General Counsel, Waddell & Reed, Inc.

*Fee Litigation Under Section 36(b).* The panel began by discussing the current status of excessive fee litigation under Section 36(b) of the 1940 Act. Mr. Colby remarked on the positive trend for investment advisers in 36(b) litigation, noting that (i) the filing of new cases has tapered to a trickle with only two new cases brought in the last two years, (ii) only eight active cases remain, with most close to conclusion and (iii) the number of dismissals as final resolutions has been increasing.

Ms. Ulstrup then reported breaking news from the Second Circuit Court of Appeals, which had just affirmed the district court's decision in *Pirundini v. J.P. Morgan Investment Management, Inc.*, a suit alleging excessive fees in the adviser vs. sub-adviser context that had been decided at the motion to dismiss stage in favor of the defendant. Although the affirmance is a good result, Mr. Fleckner noted a negative implication in Judge Korman's concurring opinion where he stated he was only concurring because the Second Circuit case law required him to do so, but that in his view, *Amron v. Morgan Stanley Investment Advisors, Inc.* effected a judicial repeal of Section 36(b) by imposing a pleading standard that cannot be satisfied without discovery. Despite the fact that Judge Korman's concurrence reads more like a dissent, Mr. Colby suggested Judge Korman's statements were not well-supported, as *Pirundini* was only the third of the nearly 30 cases brought to be dismissed on a Rule 12(b)(6) motion post-*Jones v. Harris*.

Mr. Colby then discussed the recent trial decision from the US District Court for the District of New Jersey in *In re BlackRock Mutual Funds Advisory Fee Litigation* from February 2019. He noted that *BlackRock* falls within a group of excessive fee cases in which the plaintiffs allege that advisers charge their proprietary funds higher advisory fees than they charge as subadvisers to externally-managed funds using a similar strategy. Mr. Colby noted that *BlackRock* is the first case from this group of cases to have resulted in a decision following trial. In what Mr. Colby described as a "very strong opinion," Judge Freda Wolfson held that the plaintiffs failed to prove by a preponderance of the evidence that the fees charged by BlackRock were so disproportionate that they could not have been negotiated at arm's length.

Mr. Colby highlighted six things of note from Judge Wolfson's opinion. First, he noted the court's finding that plaintiffs' attempt to compare services provided as a subadviser to those provided to BlackRock's proprietary funds was "superficial." Second, Mr. Colby indicated that the court treated the board process factor as the most important one, and that as other courts have recently done, it rejected the plaintiffs' "captious nit-picking" as not being legitimate challenges to the board process. Third, Mr. Colby noted the court's helpful maintenance of a real standard for plaintiffs to satisfy in proving the existence of economies of scale. In *BlackRock*, the court found the plaintiffs had not met their burden because they and their expert failed to conduct a per-unit transaction cost analysis demonstrating economies of scale. Fourth, Mr. Colby noted the court's helpful finding with respect to third-party service providers – i.e., that third-party service providers are involved in providing services to the proprietary funds, does not take away from the responsibilities the adviser maintains to the funds. Mr. Colby then commented on the court's finding of inherent risks, including regulatory, reputational, and financial, incurred by advisers even when there are limitations of liability provisions in the investment management agreement. The court noted that these risks are not similarly incurred by subadvisers. Finally, Mr. Colby noted that, consistent with other recent Section 36(b) decisions, Judge Wolfson credited the third-party fee comparisons provided by organizations like Lipper as reliable evidence for boards to consider when evaluating fees.

In response to audience questions about how industry participants can best protect themselves in these litigations, the panel then discussed the importance of "showing your work," especially in the context of demonstrating a robust board process. The panel noted that the board's consideration of all relevant factors, even if certain steps are not ultimately adopted, has proven critical in the defense of Section 36(b) claims.

Finally, the panel discussed the "fiduciary exception" and its recent application in the context of

Section 36(b) litigation. Ms. Lepentis urged counsel to make sure their fund board members understand that communications with independent counsel can become discoverable and to craft communications based on that assumption.

*Fee Litigation Under ERISA – Proprietary Funds.* The panel discussed recent fee litigation under ERISA and noted that, unlike Section 36(b) litigation, there have been no signs of the plaintiffs slowing down in this area. Mr. Fleckner noted that since 2010, 35 cases have been brought, including some against the same adviser a second time after settling the first case. The general thrust of the plaintiffs' allegations is that asset managers breach their fiduciary duties by selecting their own investment products for their employees' 401(k) plans because that selection of investments is not in the best interest of the employees. Mr. Fleckner discussed the mixed results issued by the courts, though noted more positive results in recent months, including a complete dismissal for defendants in *Wildman et al. v. American Century Services LLC et al*. in September 2018. In *Wildman*, the court focused on the process used by the fiduciaries in determining which American Century funds should be included in their employees' retirement plan. The court rejected across-the-board requirements that asset managers only provide a certain number of funds so as not to overwhelm employees or that the asset manager must include index funds in the menu.

Mr. Colby then discussed a circuit split that has developed relating to the question of loss causation. Some circuits have held that if plaintiffs can demonstrate a breakdown in the fiduciary process of selecting the funds at issue, the burden shifts to the defendant to demonstrate that no loss resulted from that breakdown in process. Other circuits have held that showing loss causation is a fundamental part of the plaintiffs' case and thus no shift in burden should take place. Mr. Colby noted that it remains to be seen whether the Supreme Court will review the issue.

*Prospectus Liability/Disclosure-Based Litigation.* The panel discussed prospectus liability and disclosure-based litigation, which has remained relatively quiet. Although only a few lawsuits have been filed in recent years on the basis of prospectus liability or disclosures, Mr. Colby noted that this type of litigation bears monitoring for three reasons: namely (i) claims under the Securities Act of 1933 and Securities Exchange Act of 1934 continue to be a viable path of liability for the plaintiffs' bar, (ii) once a case survives a motion to dismiss, it is expensive to litigate and expensive to settle and (iii) disclosure-based litigation generally spikes when markets experience volatility and decline.

The panel briefly addressed the concern that existed following the Supreme Court's decision in *Cyan, Inc. v. Beaver County Employees Retirement Fund* that more lawsuits under the Securities Act would be filed in state court. The panel noted that these concerns have not borne out yet, but that we may still see an uptick in state court actions if and when disclosure-based litigation picks up.

## GENERAL SESSION

### ***Looming Ethics Issues for Lawyers and Other Industry Professionals***

**Speaker:** Jack Marshall, President and Founder, ProEthics, Ltd.

Jack Marshall, a Washington, DC-based ethics expert, presented a series of ethics scenarios based on several real-world cases. The scenarios were designed to remind lawyers that ethics dilemmas arise in many situations, and solutions are not always obvious.

*Non-Lawyer Assistants.* A celebrity lawyer was engaged to represent under-fire Hollywood mogul HW in connection with various sexual harassment and sexual assault investigations. At HW's insistence, the lawyer personally signed a contract with an investigative organization with a reputation for using aggressive tactics. The investigators were seeking to dig up dirt on several *New York Times* reporters who were reporting on HW's case. At the same time, the lawyer's firm also represented the *Times* in connection with several defamation cases. When the *Times* discovered that its lawyer had also been representing HW, they were furious about the conflict of interest. The lawyer argued that, while he regretted taking on the HW representation, he did not technically have a conflict of interest.

Mr. Marshall stated that, although the lawyer was technically correct that in the relevant jurisdiction he did not technically have a conflict of interest, that is not a winning answer for your clients. He noted that the lawyer's personal relationship with HW impaired his independent and objective judgment, leading to a potential breach of his duty of loyalty to the *Times*. He stated further that, if the lawyer was aware of what the investigators would be doing, it would have been a breach of ethics since attorneys remain responsible for the actions of non-attorneys they engage in service of firm clients. Mr. Marshall noted that, in certain jurisdictions, including New York and DC, the lawyer's actions would have violated ethics rules by prejudicing or otherwise damaging his client. He advised that the lesson is be careful who you work with. Even if the client insists that you work with particular non-lawyers, understand who you are being asked to work with and what their role will be. He stated that, if you would not be comfortable engaging the non-lawyers yourself, you should talk to the client about pursuing alternative arrangements.

*Loyalty and Personal Conflicts.* A Beverley Hills real estate developer seeking approval of a new project in the city hired an attorney with significant real estate development experience. This was odd, because the lawyer's experience involved *opposing* development projects. Given the attorney's intimate knowledge of the zoning approval process, and despite howls of protest from his wife and his former anti-development allies, he managed to get the real estate developer to the threshold of obtaining the required zoning approvals. However, the attorney suddenly resigned from the engagement – perhaps fearing permanent banishment to the sofa courtesy of his wife – and took up the fight against the development by organizing a voter referendum on the project.

Mr. Marshall stated that the developer sued the attorney for a breach of fiduciary duty and malpractice, and the lower court found that the attorney did not have a conflict of interest provided that he did not violate any client confidences. However, on appeal the California Supreme Court found that the attorney had the burden of proving that he did not violate client confidences. He noted that, while there may be compelling First Amendment arguments against this result, the Court concluded that the attorney could not take actions that are inconsistent with his former client's interest. Mr. Marshall said that, had the lawyer merely resigned the engagement and stood aside while others argued against the development, he would not have acted against his client's interests. However, by taking an active public role in opposing his former client's project, including organizing a referendum, the attorney harmed his client.

*Complexity.* A multinational oil company was ordered to pay billions of dollars to a South American country as compensation for environmental damage and public health problems arising from its local operations. The oil company hired a large law firm to defend it. A different member of the same law firm was at the time involved in a class-action lawsuit against the same oil company. In the class-action lawsuit against the oil company, the law firm filed a brief arguing a particular theory of the oil company's liability. The attorneys for the South American country managed to obtain this class-action brief and filed it as an exhibit in the other case where the law firm was defending the oil company, arguing that the law firm did not even believe its own theory of the oil company's liability.

Mr. Marshall noted that, in this case, the law firm suffered from what is known as a "positional conflict." He stated that, in certain jurisdictions, attorneys must avoid positional conflicts, meaning an attorney should not knowingly take on a representation that is likely to harm the interests of its other clients.

*Technology.* Mr. Marshall discussed a recent California Bar legal ethics opinion finding that attorneys have an ethical duty of competence to keep up with evolving electronic legal practice technologies. At a minimum, litigation attorneys must have a basic understanding of, and facility with, issues relating to e-discovery, including the discovery of electronically stored information. He said that, in certain cases, this duty of competence requires an attorney to have a higher level of technical knowledge and ability, and to seek assistance if he or she does not possess the requisite knowledge or ability. Attorneys either must acquire sufficient knowledge and skill before performance is required, associate with or consult technical consultants or competent counsel or decline the client representation. Further, he said that an attorney's lack of competence in e-discovery issues could lead to an ethical violation of an attorney's duty of confidentiality if client information is exposed to third parties.

Mr. Marshall suggested that, beyond this ethics opinion, attorneys must be aware of how they use technology to communicate with and on behalf of their clients. He said that, when using e-mail, text messaging or social media, attorneys should be acutely aware of what they communicate and who they are communicating with, as well as any vulnerabilities these media may have. In addition, attorneys must take steps to prevent and detect cybersecurity attacks. He noted that it is important to ensure that passwords are secure and that if you make use of cloud storage, the client has given informed consent to such usage.

*Business Realities Versus Professional Values.* The law firm that represents the manufacturer of the world's most popular soft drink earns a significant portion of its firm-wide revenues from this client. A very high profile partner was recruited to the firm to establish a constitutional law practice. The partner did not represent the soft drink manufacturer, but was hired by the US Congress to assist it in litigating a case where the Executive Branch declined to enforce a US statute relating to marriage equality. A number of social justice organizations began to put public pressure on the soft drink manufacturer to terminate their long-standing relationship with the law firm. Mr. Marshall stated that, while the manufacturer did not expressly threaten to terminate the client relationship, it was clear to the law firm that the continued representation of the US Congress on the constitutional matter would create friction if it continued. Therefore, the law firm resigned from the engagement with the US Congress, alleging that the process used for vetting the engagement was inadequate. Mr. Marshall noted that the partner leading the engagement promptly resigned from the firm and expressed strong disappointment that the firm abandoned a client because of the unpopularity of the representation, declaring that "Defending unpopular decisions is what lawyers do."

Mr. Marshall suggested that the modern practice of law requires attorneys to be aware of changing technologies and the role of such technologies in servicing clients. Mr. Marshall's real-world examples provided useful reminders that lawyers must affirmatively monitor client engagements and regulate their behavior to ensure that they do not act in conflict with the interests of clients.

## GENERAL SESSION

***Alert Level Red, Yellow, or Green: How's Your Anxiety Level?***

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

**Speaker:** Frank Knox, Chief Compliance Officer, John Hancock Financial Services, Inc.

Christopher Michailoff, Senior Director and Associate General Counsel, TIAA

Brian K. Reid, Independent Director, Prudential

Mara L. Shreck, Managing Director, Head of Regulatory Affairs—Asset and Wealth Management, J.P. Morgan Chase & Co.

Nicole Trudeau, Chief Legal Officer, Saturna Capital Corporation

Joshua A. Weinberg, Managing Director and Managing Counsel, State Street Global Advisors

Anita M. Zagrodnik, Senior Vice President and CCO, US Bank Global Fund Services

In the final session of the conference, panelists were asked to express their levels of concern over the next twelve months on various topics. Attendees also voted to express their level of concern. Red votes indicated that a topic was very concerning, yellow represented an issue with a lower alert level or where it was too soon to know, and green meant there was no concern. Some of the topics discussed by the panelists are described below.

*State privacy laws.* All panelists voted red, except for one panelist who voted yellow because the privacy office of the panelist's organization is focused on privacy issues. Of attendees, only 31% voted red and 53% voted yellow.

*States adopting fiduciary duty standards for broker-dealers and investment advisers.* All panelists voted red, except for one who voted yellow, while only 33% of attendees voted red (with 52% voting yellow). Panelists expressed concern about fragmentation and disparity among states creating compliance complexity for fund complexes and confusion among shareholders about what standards apply to their transactions.

*Attacks on quantitative model source data by sovereign states or other bad actors.* Panelists voted 4 red and 3 yellow, while attendees were somewhat less concerned at 55% yellow, 36% red and 9% green. Panelists noted the intensity with which sovereign states pursue cyber attacks and the challenges of identifying all models used in an organization, which is the first step having good model risk governance.

*End of LIBOR.* Both panelists and attendees voted mostly yellow and green. The panelists noted that a lot of work will be necessary to identify all affected contracts and make appropriate changes, but that organizations should have enough lead time to get the work done.

*SEC's share class enforcement initiative — risks of self-reporting and not self-reporting when an "amnesty" program offered.* Six of the seven panelists voted yellow, while one panelist voted green. In contrast, 24% of attendees voted red, with 38% voting yellow. One panelist expressed the policy view that this kind of program can help push the industry to focus on investors, and it could help address the trust problem between the industry and the investing public. Another panelist noted the trust problem between the industry and the SEC, making it difficult for organizations to decide to self report.

*What will happen when OCIE exams focus on compliance with the liquidity rule — risks of second-guessing?* Panelists were split, 4 yellow, 2 green and 1 red, with attendees in broad agreement with the panelists' votes. Panelists who voted green noted that their systems are not perfect, but they are ready for use and there are more important issues to focus on at this point. The panelist who voted red said that the risks include false positives in light of the use of backwards-looking models and reliance on checklists and rule books stifling conversation and analysis about portfolio liquidity.

*SEC's ability to secure data.* All panelists voted red, while attendees were 74% red and 21% yellow. One panelist noted that all cyber matters should be red because there are so many bad actors, while another commented that cybersecurity is a never ending arms race and hopefully the government is dedicating the right resources. One panelist noted the additional risks that any government shutdown could create.

*Chairman Clayton's statements that SEC staff statements are non-binding and create no enforceable legal rights.* Panelists were split 4 yellow and 3 green, with the attendees broadly in agreement at 62% yellow, 22% green, and 16% red. Ms. Salmon noted that press reports subsequent to Chairman Clayton's statement suggest that his statement may have been made, in part, in response to action by the New Civil Liberties Alliance seeking to require any agency action to go through the Administrative Procedures Act process.

*SEC's best interest standard.* All panelists voted yellow, while attendees were 61% yellow, 30% green, and 9% red. One panelist noted it is too soon to tell and, in particular, it is too soon to know whether it could cause states to forgo adopting additional requirements.

*Proxy voting reform.* Panelists voted 4 yellow, 2 green, 1 red, with attendees in broad agreement at 50% yellow, 39% green, and 11% red. One panelist noted inconsistent feedback among market participants that is creating potential uncertainty for that organization.

*Rule 30e-3 — Notice and access for shareholder reports.* All panelists voted green, applauding the prospect of the rule reducing costs, while attendees were 85% green and 14% yellow.

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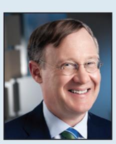

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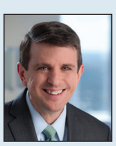

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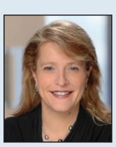

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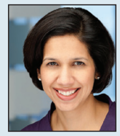

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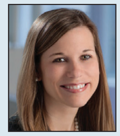

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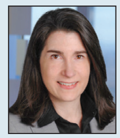

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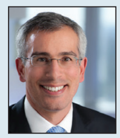

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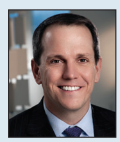

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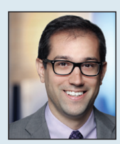

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