SUMMARY

2021 MUTUAL FUNDS AND INVESTMENT MANAGEMENT CONFERENCE

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Sponsored by the Investment Company Institute and Federal Bar Association

March 15, March 17 and March 19, 2021

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Welcoming Remarks

Speaker: Michelle Rosenberg, General Counsel and Company Secretary, Janus Henderson Investors

Ms. Rosenberg provided brief opening remarks. She talked about the challenges brought about by the COVID-19 pandemic and the asset management industry's ability to address those challenges. In particular, she discussed the challenges of working remotely and how industry employees successfully transitioned to working remotely in a very short period of time. In addition, she discussed the resiliency of the industry in light of both significant market and political uncertainty. Finally, she talked about some of the positive changes that the industry has experienced, including the potential for increased connectivity with clients.

Keynote Address

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

Mr. Pan began by noting that this is his first Mutual Fund and Investment Management Conference as President of the Investment Company Institute (ICI). He indicated that currently he is working with ICI members to identify industry priorities.

The main focus of Mr. Pan's remarks was the market turmoil of March 2020, with a particular emphasis on the suggestion that long-term bond funds (LTBFs) and money market funds (MMFs) represent systemic threats. He explained that while the ICI supports appropriate regulation and looks forward to working with regulators on targeted reforms, the ICI is concerned that regulators will propose sweeping reforms based on insufficient data and place undue blame on LTBFs and MMFs. Describing the 2020 market volatility as a situation in which the demand for liquidity exceeded available supply, he lauded regulators for taking swift and decisive action to mitigate the market liquidity crisis.

Mr. Pan explained that in the ICI's view, regulators should investigate the factors that led to the market turmoil, including the fact that the structure of the fixed income markets contributes to liquidity challenges. He noted that demand for US dollar assets was high, and it was not the assets themselves that created the challenges. He added that the fact that regulators stepped in to restore liquidity does not mean that LTBFs and MMFs need significant additional regulation to ensure that there is no further need for central bank intervention. He argued instead that regulators must acknowledge the important

role that LTBFs and MMFs play in a system of active capital markets.

Mr. Pan cautioned regulators to not ignore the reforms undertaken in response to the global financial crisis in 2008-2009, adding that the pursuit of market resilience should not come at the expense of the health of the overall system. He observed that reforms should not create unintended consequences and urged regulators to look at the interaction of regulation and the markets to determine whether reform measures created more problems than they solved. As an example, Mr. Pan cited proposals to establish capital requirements for certain non-bank financial institutions. He suggested that policy makers and regulators must realize that there are significant differences between markets, and they should not seek a one-size-fits-all solution.

With respect to MMFs, Mr. Pan noted that the Financial Stability Board is reviewing the events of March 2020. He added that the recent Report of the President's Working Group on Financial Markets made ten suggestions regarding potential policy measures relating to MMFs without endorsing any of the suggestions. He explained that the ICI thinks it is important to retain the usefulness of MMFs by strengthening them. He noted that certain changes to MMFs, such as instituting swing pricing and requiring capital buffers, may have unintended consequences that will impact yields.

With respect to LTBFs, Mr. Pan rejected the suggestion that such funds amplified the liquidity problems experienced in March 2020. Citing an ICI analysis published in response to the March 2020 market turmoil, he noted that investors behaved in March 2020 the same way they seem to behave in every crisis, but added that the size of this market shock was extraordinarily large. He argued that it is too early to determine whether LTBFs exacerbated the problems experienced in the fixed income markets.

Mr. Pan reiterated his view that the structure of the fixed income markets contributed to the March 2020 turmoil, not fixed income securities or LTBFs and MMFs themselves. He urged regulators to carefully calibrate any reform proposals to ensure that the strength and utility of the fixed income markets and LTBFs and MMFs are not impaired. He advised regulators to follow the evidence and consider the long-term impact of any proposals on the capital markets. He concluded by noting that the challenges presented by the COVID-19 pandemic and the resulting market turmoil in March 2020 were unprecedented, but the response of

regulators and policy makers should be measured.

Developments in Asset Management: Keeping up with the Regulators

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

Speakers: Bruce G. Leto, Partner, Stradley Ronon Stevens & Young, LLP

Naseem Nixon, Counsel, Capital Research and Management Company

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

The panel discussed recent rules adopted by the SEC, as well as potential upcoming rulemaking on which the Division of Investment Management will focus. A consistent theme during the course of the panel was the need for the SEC staff to be aware of the "ripple effects" of rulemaking throughout an organization and its operations. The panel encouraged Ms. ten Siethoff and the SEC staff to continue engaging with the industry regarding proposed rulemaking and areas of focus, noting that this will result in better-informed rulemaking and more efficient utilization by the industry of its resources.

The panel discussed the following recently adopted rules under the 1940 Act:

Valuation Rule (Rule 2a-5). While the compliance date for the valuation rule is September 8, 2022, the panelists noted the importance of focusing on the rule sooner, because of the various work flows that will need to be addressed – *e.g.*, compliance policies and reporting to the board. The panelists discussed the collateral impact of the rulemaking on fixed income cross trades, and encouraged the SEC staff to address these issues in a timely fashion, noting that the staff's recent request for feedback on the regulatory regime applicable to cross trading was a positive step. Ms. Nixon noted that the industry cannot move toward compliance with the new valuation rule until this issue is settled.[1] Ms. ten Siethoff stated that, in response to a number of questions received

[1] We note that on March 18, 2021, the staff of the Division of Investment Management addressed this issue in its responses to frequently asked questions related to the adoption of Rules 2a-5 and 31a-4, which are available here: https://www.sec.gov/investment/valuation-faq. The staff stated that "if a fund chooses to comply with rule 2a-5 before its compliance date, the staff would not object if the fund does not apply rule 2a-5's definition of readily available market quotations to its cross-trading practices under rule 17a-7 until the Sept. 8, 2022 compliance date."

by the SEC staff, the industry should expect to see additional guidance regarding the new valuation rule.

Fund of Funds Rule (Rule 12d1-4). The panel noted that complexes are in the process of evaluating what, if anything, will need to change in their funds of funds structures as they transition to relying on the new rule as opposed to existing orders and guidance. Ms. ten Siethoff noted that she expects the industry will see guidance from the SEC staff regarding some aspects of the fund of funds rule about which the staff has been seeing questions.

Derivatives Rule (Rule 18f-4). The panel discussed early steps being taken to prepare for the derivatives rule, including categorizing funds based on whether they will be able to operate as "limited derivatives users" or will need to adopt a full derivatives risk management program. Ms. ten Sietfhoff said that the SEC staff has not received many questions on the new derivatives rule.

The panel then discussed upcoming areas of regulatory focus, including (i) ESG matters, (ii) disclosure reform and (iii) money market funds, some of the highlights of which are summarized below.

Regarding ESG, Ms. ten Siethoff described the SEC staff's disclosure-related expectations:

- For all funds that claim they consider ESG factors, describe how they define ESG factors, disclose whether they intend to focus on any particular aspect of ESG (*i.e.*, environmental, social or governance), disclose whether ESG factors are considered for all potential investments, disclose whether ESG factors are the exclusive factors considered or one of many factors considered and disclose any related principal risks,
- For funds that are clearly focused on ESG as a primary consideration in the investment process, disclose how ESG selections are determined (*e.g.*, choosing investments by reference to an index or third party organization's screening or proprietary screening) and
- For funds that identify externally as ESG funds, include more detailed disclosure that addresses the expectations described above.

The panelists debated the SEC staff's position that a fund with ESG-type terms in its name should adopt a policy to invest 80% of its assets in ESG investments, with Mr. Leto noting the industry's view that a fund with an ESG focus is implementing a strategy as opposed to making a specific type of investment. Mr. Leto also noted that the implementation of some of the SEC staff's ESG-related views through the disclosure

review process has resulted in an uneven playing field for participants.

Regarding disclosure reform, Ms. ten Siethoff stated that the big-picture goal is to re-think how information can be conveyed to investors so that it is easier to digest. She stated that the industry should expect to see continued movement toward a layered approach, with additional information available to investors online. She noted that most of the open questions are around how the layers will be delivered to investors. The panelists debated balancing a fund's need to protect itself from litigation with the goal of making the disclosure easy to read and understand. Mr. Leto noted that while there was general agreement about making shareholder reports more investor-friendly, the cost associated with the proposed changes may be very high.

Regarding money market funds, Ms. ten Siethoff stated that the SEC staff is focused on identifying recommendations on potential reform measures, noting that the SEC staff issued a request for comment on the recommendations made in the recent Report of the President's Working Group on Financial Markets.

Changes in Administrations: What Does It Mean for Examinations and Enforcement?

Moderator: Katherine M. Primas, Chief Compliance Officer, Dodge & Cox

Speakers: Adam S. Aderton, Co-Chief, Asset Management Unit, Division of Enforcement, US Securities and Exchange Commission

Amy R. Doberman, Partner, Wilmer Cutler Pickering Hale and Dorr LLP

Peter Driscoll, Director, Division of Examinations, US Securities and Exchange Commission

The panel focused on inspection and enforcement trends at the SEC and areas of focus for 2021. Ms. Primas began the panel discussion by providing an overview of the work of the Divisions of Examinations and Enforcement in 2020. She emphasized the high level of activity in both Divisions in 2020 and to-date in 2021, notwithstanding the challenges presented by COVID-19 and the remote-working environment.

Division of Examinations Priorities. Mr. Driscoll provided an overview of the priorities

for the Division of Examinations in 2021.[2] He first discussed the Division of Examinations' attention to climate and ESG-related risks in light of the high level of interest and growth of assets in ESG products. He stated that the Division is focused on reviewing the consistency and adequacy of the disclosures provided by investment advisers and fund complexes to clients concerning ESG strategy, determining whether the firms' processes and practices align with their disclosures and reviewing fund advertising for false and misleading statements. Ms. Doberman urged caution with respect to the dangers of overly promissory disclosure and exaggerated performance claims for ESG funds, noting the challenges inherent to using projections and back-testing given the subjective nature of ESG factors, rankings and descriptions. Ms. Doberman also highlighted concerns that the industry may learn the SEC's views on ESG primarily through examination and enforcement, rather than through regulation. Messrs. Driscoll and Aderton suggested that their focus in the first instance is considering whether firms' processes and practices match their ESG disclosures, noting that both Divisions' examination results would be regularly shared with other divisions in the SEC and would inform any rulemaking for ESG funds. Mr. Driscoll also stated that the Division expects to issue to a risk alert in the coming weeks summarizing its examination findings to date.

Mr. Driscoll then turned to other priorities of the Division of Examinations, noting that the Division will continue to focus on side-by-side management of mutual funds and private funds and, in particular, on how an investment adviser's compliance department and a mutual fund's board oversee the conflicts of interest associated with side-by-side management. He also discussed several areas of focus for ETFs, including (i) the conversion of mutual funds into ETFs and related disclosure, (ii) oversight of processing of Authorized Participant subscriptions and redemptions, (iii) sales practices and disclosure for leveraged and inverse ETFs and (iv) compliance with exemptive relief for newly created semi-transparent, actively managed ETFs. The panel considered the uncertainty surrounding the allocation of responsibility between investment advisers and index providers, noting the importance of maintaining good controls for index tracking and rebalancing appropriately. Mr. Driscoll

[2]On March 3, 2021, the SEC's Division of Examinations published its 2021 Examination Priorities, which are available here: https://www.sec.gov/files/2021-exam-priorities.pdf.

then noted that the Division would continue to focus on valuation practices, discussing in particular how certain asset classes were priced during periods of market stress in 2020 and the Division's interest in whether firms made changes to valuation through the application of policies and procedures or through overrides. He also acknowledged the uncertainty that the SEC's new valuation rule (Rule 2a-5) has created for cross trades under Rule 17a-7 in certain fixed income securities beginning in September 2022 (the compliance date for Rule 2a-5). Mr. Driscoll encouraged market participants to respond to the SEC staff's March 11, 2021 statement requesting comments concerning potential amendments to Rule 17a-7.

The panel then discussed cybersecurity risks associated with the current remote-working environment. Mr. Driscoll noted an increase in ransomware, credential stuffing and denial of service attacks and commented on the Division of Examinations' focus on firms' oversight of and controls for data sharing with service providers. He also said that the Division continues to focus on firms' disaster recovery plans in the event of a cybersecurity incident, including timely notice to regulatory authorities, affected parties and service providers.

Notable Enforcement Actions in 2020. Mr. Aderton provided a brief overview of four enforcement actions from 2020, in each case sharing his views regarding the most salient lesson from the enforcement action. He first discussed the SEC's September 2020 order against Transamerica Asset Management, Inc. regarding Transamerica's alleged material misstatements and omissions to investors regarding the annual operating expenses of four money market funds. Mr. Aderton highlighted the importance of Transamerica's cooperation with the Division of Enforcement, noting, among other things, that Transamerica identified the relevant issues, hired a third-party consultant to facilitate its internal investigation, self-reported the conduct to the SEC and cooperated fully with the Division of Enforcement's investigation. He stated that, in light of Transamerica's extraordinary cooperation, the Division of Enforcement did not issue a penalty in a case where it otherwise would have. Mr. Aderton also discussed the SEC's July 2020 order against Franklin Advisers, Inc. alleging Franklin's breach of its fiduciary duty to client funds and failure to follow its own policies and procedures. He emphasized the order's conclusion that Franklin failed to disclose to the funds' board losses associated with a violation of Section 12(d)(1)(A) of the 1940 Act, Franklin's decision not to reimburse related

losses and Franklin's deviation from the funds' trade error policy, noting that these failures created a more serious enforcement action than would have otherwise resulted from the underlying compliance violation.

Mr. Aderton then discussed the SEC's September 2020 order against Palmer Square Capital Management LLC concerning cross trades between clients' accounts. He stated that the Divisions of Examination and Enforcement are focused on identifying patterns of activity where they believe a fund may be consistently or systematically disadvantaged. He also highlighted the importance of ensuring compliance with all requirements of an exemptive rule, noting that the SEC found that Palmer Square believed that it did not need to comply with the requirements of Rule 17a-7 with respect to cross trades involving a registered fund to the detriment of participating registered funds. Mr. Aderton concluded by discussing the SEC's December 2020 order against ICE Data Pricing & Reference Data LLC for compliance deficiencies relating to its delivery to clients of single broker quotes. He emphasized the importance of testing controls to ensure that such controls operate as intended and are consistent with applicable policies and procedures, and he noted that the order found that ICE's quality controls for prices on single broker quotes were not effective or consistently implemented.

New Leadership. The panel then discussed the potential impact of changes implemented by the Biden Administration and new leadership at the SEC. Mr. Aderton stated that the power to subpoena testimony and documents had been delegated to senior officers, rather than residing with the Division of Enforcement, permitting more efficient investigations. Mr. Aderton also discussed that, effective January 1, 2021, Congress significantly enhanced the SEC's enforcement authority by explicitly authorizing the SEC to seek disgorgement for unjust enrichment and by doubling, from five to ten years, the time the SEC will have to bring actions for scienter-based violations. He stated that these changes are part of the National Defense Authorization Act for Fiscal Year 2021.

KEYNOTE SPEAKER

Speaker: Allison Herren Lee, Acting Chair, US Securities and Exchange Commission

Acting SEC Chair Lee's remarks focused on the importance of fund proxy voting and related disclosures. She noted that through clear and timely disclosure, investors are empowered to hold the companies they own accountable, including accountability on

climate and ESG matters. She expressed concern that SEC regulations have not kept pace with the new landscape of institutional investor-driven corporate governance.

Chair Lee noted two key trends that necessitate updates to SEC rules and guidance regarding proxy voting: (i) the dramatic growth in the percentage of US households that own index funds and the resulting increased reliance on index funds to vote in annual corporate elections and (ii) soaring demand for opportunities to invest in vehicles with ESG strategies. She noted that the rise of index funds may operate to the detriment of corporate accountability – and on ESG matters in particular – given that SEC rules have not kept up with these developments. She explained that although investors are demanding ESG investment opportunities, funds may not always reflect those preferences in their voting.

She noted that because index funds are limited in their ability to sell out of positions, proxy voting is a particularly important tool for maximizing value. Yet, index funds face economic pressure to lend out their shares, or not recall their shares, instead of voting. She noted that while securities lending can lower fund costs, this should be carefully balanced against the value to shareholders in exercising voting rights. Chair Lee noted that an investment adviser's decision not to exercise voting rights requires careful consideration. She expressed concern that the SEC's 2019 guidance regarding proxy voting responsibilities of advisers attempted to, and may have, tilted this calculus against shareholder voting without sufficient data or analysis to support the wisdom of doing so. She stated that this guidance should be revisited to ensure that fiduciaries understand how to weigh competing concerns of all types in deciding whether and how to cast votes consistent with their fiduciary duties.

Chair Lee addressed the limitations of Form N-PX and indicated that she has asked the SEC staff to begin preparing options for updating Form N-PX to make it more useful for investors. She noted that a new rule could, for example, standardize voting disclosures, structure and tag the data, provide more clarity in the description of issues voted on, provide the number of shares voted versus shares available to vote and facilitate more timely disclosure so investors can act quickly to reward fund managers that best match the investors' needs and expectations. Chair Lee noted that, because new regulations will take time to implement, in the near term, she has asked the SEC staff to develop options for how the SEC can improve transparency using existing data sources.

Finally, Chair Lee observed that structural voting issues pose tremendous challenges to funds. She noted that funds as issuers face a unique landscape as their ownership is highly intermediated and diffuse, making it difficult and expensive to identify shareholders and obtain a quorum. Conversely, she noted that when funds and advisers exercise their authority to vote, it is often difficult to obtain vote confirmations given the multitude of intermediaries involved in the voting process. She noted that both of these issues deserve attention as the SEC examines and attempts to modernize the proxy voting system.

A complete copy of Chair Lee's remarks can be found here: https://www.sec.gov/news/speech/lee-every-vote-counts

Asset Management in the Time of COVID-19: The New Normal?

Moderator: Kate McKinley, General Counsel, State Street Global Advisors

Speakers: Stephanie A. Capistron, Partner, Dechert

Michelle Rhee, Deputy General Counsel for Wealth and Investment Management, Wells Fargo

Matt Wolfe, Managing Director, Compliance and Legal, GuideStone

The panel discussed issues that asset managers face as the industry continues to work-from-home in light of COVID-19 and as firms prepare for a more general re-opening and return to the office.

Work-From-Home. Mr. Wolfe discussed compliance-related challenges in the work-from-home context, noting in particular the degree of overlap between the August 2020 risk alert issued by the SEC's Office of Compliance Inspections and Examinations (OCIE) and the 2021 examination priorities recently published by the SEC's Division of Examinations. He emphasized that asset managers should pay attention to the following areas that may be a particular focus of upcoming exams: (i) protection of investor assets, (ii) business continuity, (iii) cybersecurity, (iv) oversight of vendors and service providers and (v) employee supervision of communications and trading activity.

With regard to oversight of vendors and other service providers, Mr. Wolfe discussed the benefits of virtual diligence reviews, such as facilitating more frequent meetings, meeting with more vendor personnel that might be in different locations and the

inclusion of specialist asset manager personnel, including information security officers, who normally might not travel to physical onsite meetings. He remarked that he would not expect virtual diligence meetings to completely replace physical onsite meetings, but noted that even after a general re-opening, virtual meetings may continue to provide high quality and more frequent touch points, potentially on specific topics.

Ms. McKinley discussed the challenges of trading desk oversight, the use of recorded lines and other matters that implicate both regulations as well as corporate policy. She highlighted a firm policy that had previously prohibited employees from printing work documents at home in order to protect sensitive information. She noted that the policy, while well-intentioned, prevented some people from working as efficiently at home as they would have in the office. She noted the importance of employee education regarding exemptions that are granted to corporate policies. Ms. McKinley also remarked that the use of short communications from compliance personnel with practical, actionable tips and related compliance reminders may be useful tools to help employees succeed. She noted that these practices had been well received and highly effective on various subjects, such as codes of ethics, market manipulation, information sharing and the use of social media. She also commented that the increased use of simulated exercises, for example around phishing, for targeted segments of employees had been an effective strategy.

Ms. Capistron discussed regulatory requirements that were difficult or impractical to abide by in a work-from-home environment because they involved processes predicated on being in the office or in-person. She discussed the use of electronic signatures for SEC filings, document delivery (filing, printing and mailing), shareholder meetings, the requirements for in-person meetings under the 1940 Act and recordkeeping requirements. Ms. Rhee commented on how manual processes in connection with recordkeeping practices can lead to elevated risks in the work-from-home environment.

Ms. Rhee discussed the continued acceleration of social media use in the work-from-home context. She pointed out that many asset managers have limited purpose broker-dealers that are subject to FINRA requirements mandating a reasonably designed compliance program that effectively supervises employees communicating with the public. She noted that there could be

grey areas about whether a FINRA member firm is responsible for supervising a given activity undertaken by an employee on social media. She recommended that firms consider whether those who are licensed and subject to FINRA requirements are actually required to be, based on their activities. She also raised the question of whether firms should prohibit employees from communicating in an official capacity on certain social media platforms (*e.g.*, WhatsApp) because there is no way to supervise those communications.

Return to the Office. Ms. Rhee described particular challenges faced by larger firms because there is no cohesive set of rules or standards, from a civil liability or national regulatory perspective, governing how firms should return to the office. She commented on a number of topics in this regard, such as employee privacy, health and safety and vendor liability, noting the difficulties involved with navigating premises liability considerations.

Mses. Rhee and Capistron addressed the question of whether remote work could result in new offices or branches of employers, noting that the answer may differ based on the nature of the entity (e.g., investment adviser versus broker-dealer). Ms. McKinley stated that this is one factor of many to consider as firms are making decisions regarding hiring, the size of office footprints and lease renewals. She noted that, to the extent ongoing remote work is an option for a particular job function, that might increase the potential pool of employees in terms of talent, diversity and other considerations.

Mr. Wolfe spoke about some of the factors that his company has considered in the context of returning to the physical office space. He noted that precautions have included requiring individuals to have their temperature checked and wear masks (even though masks are not currently required in the local jurisdiction). He commented on his company's open floorplan, noting that individuals are seated at least 6 feet apart, typically with at least a partial physical divider (or, if there is no divider, the employees are typically seated back-to-back). He also noted that his company's building had upgraded its ventilation system. Mr. Wolfe said that his firm had tentatively set May 3 as the date on which everyone would return to the office on at least a partial basis. He noted that employees would generally return to the office either 3 days a week or 2 days a week, depending on their role, in order to reduce the number of employees on any given day. He noted the benefits of in-person mentorship and ad hoc meetings, noting that

these are difficult to replicate in the work-from-home environment.

Ms. McKinley discussed challenges in determining what can be, or should be, required of employees as firms consider how to lead with empathy. She noted that while many people seemed to share similar concerns during the transition to work-from-home, the range of considerations among individuals may be more diverse for the transition back to the office.

Mutual Fund Civil Litigation: Year in Review

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

Speakers: John Fitzgerald, Deputy General Counsel, Lord, Abbett & Co. LLC

Mark Holland, Partner, Goodwin Procter LLP

Amy D. Roy, Partner, Ropes & Gray LLP

The panel discussed mutual fund civil litigation trends over the past year, including lawsuits relating to fund fees and disclosure, claims brought by shareholders in a derivative capacity on behalf of a fund and issues relating to closed-end funds.

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. Ms. Roy remarked on the positive trend for investment advisers in 36(b) litigation, noting that (i) no investment adviser has been found by a court to have violated Section 36(b), (ii) of the 29 excessive fee cases brought since the *Jones v. Harris Associates* decision, all but one have been fully resolved, with the one remaining case on appeal in the 10th circuit after the defendant adviser prevailed at trial and (iii) the number of dismissals prior to trial has been increasing. Mr. Holland noted that plaintiffs had agreed to dismiss several 36(b) cases before summary judgment without receiving any settlement. Ms. Roy noted that plaintiffs frequently challenge advisers' reporting to fund boards on profitability, but had been unsuccessful in challenging cost allocation methodologies that had a rational basis, were consistently applied and were disclosed to and discussed with the board. Mr. Holland explained that courts have been rigorous in requiring plaintiffs to prove the existence of economies of scale, and have been satisfied by evidence of some sharing of such economies of scale as may exist.

Ms. Roy observed that the plaintiffs' theories regarding (i) the allocation of fees and responsibilities between advisers and subadvisers in manager-of-managers structures and (ii) the difference in fees

charged by advisers to their own funds and by the same advisers when subadvising third-party funds seem to be winding down. She noted that towards the end of the recent wave of litigation, the plaintiffs' lawyers began making inquiries regarding the scope of services provided to index funds as compared to actively managed funds and, therefore, we could see activity in that regard going forward.

Ms. Roy noted that two recent decisions making six-figure awards of certain litigation costs to the prevailing defendants in the *MetWest* and *Great West* cases, though representing only a small portion of the cost of defending those cases, may put a damper on plaintiffs' firms' willingness to bring future 36(b) cases.

Mr. Fitzgerald discussed the implication of 36(b) cases for the 15(c) process, which he noted involved providing information to fund directors throughout the year. He stated that exposing fund directors to a wide range of investment adviser personnel can give directors a better sense of the breadth and depth of the services provided. Mr. Fitzgerald noted that testimony from independent fund directors had been key to the successful resolution of several 36(b) cases. He pointed out the benefits of ensuring that information is presented efficiently and effectively, and of highlighting for the board any changes in the materials they receive.

Prospectus Liability/Disclosure-Based Litigation. The panel discussed prospectus liability and disclosure-based litigation, with respect to which Mr. Holland stated that the fund industry has continued to enjoy a good run. He summarized the *ProShares* case, which had been dismissed at the motion to dismiss stage by the district court and the dismissal affirmed on appeal, noting that the court read the prospectus cover to cover, and concluded that everything the plaintiff complained about had been disclosed. The panelists agreed that robust disclosures, particularly those with respect to the risk of loss and any conflicts of interest for the adviser, make a big difference. Mr. Fitzgerald emphasized the importance in the disclosure review process of having investment personnel consider whether changes in market conditions might warrant disclosure changes, citing the example of pandemic-related disclosures that had been added to fund disclosures across the industry in 2020.

Mr. Holland stated that few cases involving 1933 Act claims have been brought in state court in the wake of the 2018 *Cyan* case, and noted that state courts had been rigorous in evaluating such claims. He noted that in light of the recent Delaware Supreme

Court decision in the *Sciabacucchi* case upholding the enforceability of a federal forum selection clause, funds might wish to consider including such a clause in their charter documents.

Derivative Litigation. Mr. Holland reported that the industry has also fared well in defending recent actions brought by shareholders in a derivative capacity on behalf of a fund. He commented on recent derivative claims with respect to the Sequoia Fund and Highland Global Allocation Fund, noting that in each case the court had deferred to the decision of a special committee of the independent fund directors not to pursue the claims after conducting a reasonable investigation of the claims in good faith. He noted that because of the limited time necessary to respond to a shareholder demand, it may be helpful for funds to have policies and procedures with respect to the evaluation of derivative demands in place in advance.

Closed-End Fund Related Activity. Ms. Roy reported that a number of activist investors had recently waged successful campaigns to elect candidates to the boards of closed-end funds and/or implement liquidity events for the funds. She noted that these occurrences have led the boards of several closed-end funds to adopt bylaw amendments with respect to the required vote in contested director elections and/or "control share" provisions, under which a person that acquires shares in excess of the specified threshold is prohibited from voting such control shares. She noted that in 2020, the SEC staff had reversed its position in the *Boulder* no-action letter that a fund opting into a control share acquisition statute would violate Section 18(i) of the 1940 Act, and stated that going forward, the SEC would not recommend enforcement action should a closed-end fund opt in to a control share statute so long as the decision was made with reasonable care and consistent with all other applicable duties and laws. Ms. Roy stated that two cases were currently pending in which an activist firm had challenged bylaw amendments and the adoption of control share provisions by closed-end funds.

Board Practices and Regulatory Developments Affecting Fund Directors

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

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

John E. Baumgardner, Jr., Independent Trustee, Pioneer Funds, Of Counsel, Sullivan & Cromwell LLP

Ndenisarya M. Bregasi, Practice Area Leader, Asset Management and Investment Funds, K&L Gates LLP

The panel explored several topics of interest to fund boards, including board practices over the past year, expected practices in the post-COVID environment, recently adopted SEC rules and policy issues.

The panel began with a review of board practices over the past year. Ms. Barr noted that it is remarkable how well boards have operated in the current environment. She stated that, in her experience, boards have not made changes to the content of their meeting materials and have not cut back on educational sessions. Ms. Barr remarked that, in a change from pre-COVID practices, she has found independent directors are having more interactions between regularly scheduled board meetings. She stated that she believes this has been a positive development and expects it will continue in the post-COVID environment. Mr. Baumgardner noted that social events – such as virtual cocktail gatherings – have enabled directors to connect with colleagues and maintain board culture and connectivity.

Mr. Baumgardner noted that many boards have placed an increased focus on recruiting and succession planning as a direct result of COVID. Ms. Bregasi noted that the initial reaction among boards at the outset of the COVID crisis was to slow down recruiting efforts, but boards soon realized that recruiting efforts and succession planning need to continue – perhaps now more than ever. The panel noted that boards have used the same virtual tools to interact with candidates that they use for board meetings. On the topic of recruiting, the panel members agreed that diversity is a key consideration in recruiting efforts.

As to the post-COVID environment, Ms. Bregasi stated that she believes boards will retain the flexibility afforded by the virtual meeting format and find ways to incorporate such flexibility into their governance practices. The panel remarked that the virtual format has enabled many boards to schedule guest speakers and educational sessions more readily without having to factor in travel time. The panel noted that it expects this practice to continue.

The panel commented on the role of the board in an investment adviser's return-to-office plans. Mr. Baumgardner noted that this is a complicated topic because not many advisers own their office buildings. Therefore,

advisers are dependent on landlords and facility managers in addition to local regulations. The panelists noted that many boards have been informed by advisers that the adviser plans on a hybrid approach to in-office and remote working as part of their return plans. Mr. Kim noted that the ICI continues to engage with the SEC on the status of the relief previously issued by the SEC from in-person board meeting requirements.

The panel next discussed certain recently adopted rules under the 1940 Act. Ms. Bregasi noted that the SEC had been especially prolific with regard to rulemaking in 2020. She noted that among the rules that are of particular importance to boards are the derivatives rule (Rule 18f-4) and the valuation rule (Rule 2a-5), for which the compliance dates are August 19, 2022 and September 8, 2022, respectively. Ms. Bregasi stated that boards are engaging with advisers on the implementation of these rules. The panel noted that the valuation rule likely involves fewer changes for boards than the derivatives rule because the valuation rule codifies much of what is already being done in practice.

Mr. Baumgardner noted that a director's experience in overseeing risk management generally will be brought to bear in the context of both rules in general and the derivatives rule in particular. He stated that boards will expect certain updates from the adviser as to various milestones relating to the derivatives rule between now and the rule's compliance date, including, among other things, a report regarding the individual(s) who will serve as derivatives risk manager and the adviser's review of each fund to determine whether the fund will be subject to the rule or whether it will qualify as a limited derivatives user. The panel commented on certain similarities between the derivatives rule and the liquidity risk management rule (Rule 22e-4) and noted that boards and advisers will likely use the same general framework for the derivatives risk management program as that used for the liquidity risk management program.

The panel discussed certain emerging policy issues. The panelists noted that ESG is raised on a regular basis in the board room. In this regard, the panel noted that it is important that a board understand what an adviser means by ESG, as there are different views and definitions used in the U.S. and Europe. The panel also noted that a board needs to understand what the portfolio managers are considering from an investment perspective with regard to ESG criteria and how, if at all, the adviser's process with regard to ESG related research is evolving. The

panel then discussed stewardship generally and board oversight of proxy voting as a particular example of where board stewardship comes into play. The panel concluded by noting that boards have relied for years on Chief Compliance Officers (CCOs). Ms. Barr stated that CCOs need to be engaged and empowered within their respective organization. Specifically, she noted that boards should inquire as to whether a CCO has roles on committees of the adviser and involvement in key product development meetings so that the CCO can effectively serve as a board's eyes and ears.

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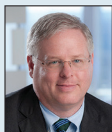

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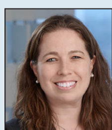

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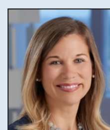

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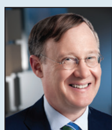

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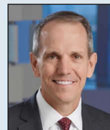

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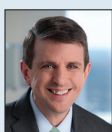

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