

# Regulatory Insights

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### SEC RULEMAKING

#### *Final SEC Rule 30e-3 – Optional Internet Availability of Investment Company Shareholder Reports*

- Rule 30e-3 will allow mutual funds to send a notice of internet availability instead of a shareholder report, effective January 1, 2021, to reduce printing and postage costs. Funds intending to rely on the rule in 2021 must disclose this change in their shareholder reports and prospectuses beginning this year (2019). Investors have the right to opt-out and continue to receive full paper reports (as they do today).
- Broadridge recently launched a comprehensive solution that enables the capture of investor distribution preferences through a centralized website ([www.FundReports.com](http://www.FundReports.com)) and, working with banks, brokers and mutual funds, it also allows for easy enrollment in e-delivery. Use of unique control numbers and QR codes simplifies the election process for shareholders (including via mobile device) by routing them directly to the website.
- On August 3, Twin River Paper Company, Consumer Action, the Paper Coalition and other entities filed suit in federal court to prevent the SEC from implementing the final rule, which became effective on January 1, 2019 (and notices can be used starting on January 1, 2021). Both parties have filed briefs with the court. Oral arguments are scheduled for March 12.

#### *SEC Covered Investment Fund Research Reports - Final Rule*

- On November 30, the SEC adopted a final rule and technical amendments to promote research on mutual funds, exchange-traded funds, registered closed-end funds, and similar covered investment funds to comply with the mandate set forth in the Fair Access to Investment Research (FAIR) Act of 2017. The FAIR Act directed the SEC to establish and implement a "safe harbor" for certain investment fund research reports published by brokers and dealers.
- New Rule 139b provides that a research report prepared by a broker-dealer unaffiliated with the mutual fund manager or sponsor will not result in an unregistered offering, and the research report will not constitute as a prospectus.
- The adopting release and final rule can be found at: <https://www.sec.gov/rules/final/2018/33-10580.pdf>

### **Proposed Regulation Best Interest/Form CRS**

- On December 11, Chairman Clayton testified before the Senate Banking, Housing and Urban Development Committee and stated that: *“The staff of the Division of Trading and Markets and the Division of Investment Management are reviewing all of this information, and the more than 6,000 comment letters as they work diligently together to develop final rule recommendations.”*
- The SEC’s Fall Reg Flex agenda lists September 2019 for final rulemaking and in a December 6 speech, Chair Clayton listed in his list of strategic initiatives for 2019.
- The SEC has released the results of its investor testing on Form CRS (Customer Relationship Summary), part of the SEC’s proposed rulemaking. Researchers at RAND conducted a nationwide survey of households to gather feedback. RAND found that more than half of respondents believe the summary is “too long,” with almost all of the remainder reporting that the length is “about right.” Another finding was that the “Conflicts of Interest” section of the form is second only to the “Fees and Costs” section in terms of reported difficulty. It is expected that a modified version of FORM CRS will be included in the final rulemaking.
- The SEC press release and RAND Survey can be found at: <https://www.sec.gov/news/press-release/2018-257>

### **Variable Annuity and Variable Life Insurance Summary Prospectus Rule Proposal**

- On October 30, the SEC proposed a summary prospectus rule for variable annuities and variable life insurance products. The rule proposal allows for the use of a summary contract prospectus in lieu of the statutory prospectus and the ability to suppress delivery of the underlying fund prospectuses if certain key information is provided in an appendix at the back of the summary contract prospectus.
  - The full statutory contract prospectus would need to be posted online and available upon request within three business days.



- The optional method to satisfy the underlying fund prospectus delivery requirements is a ‘notice and access’ model. Certain key information about the funds must be included in an appendix, including investment type or investment objective, name, expense ratio and the past 1-year, 5-year, and 10-year returns.
  - Summary and Statutory prospectuses must be posted online along with, SAIs, and the most recent shareholder reports. Upon request, materials must be sent in paper or electronically within three business days.
- Details of the rule proposal can be found at: <https://www.sec.gov/rules/proposed/2018/33-10569.pdf>
- Sample summary prospectuses and appendix can be found at:
  - <https://www.sec.gov/rules/proposed/2018/33-10569-appendix-a.pdf>
  - <https://www.sec.gov/rules/proposed/2018/33-10569-appendix-b.pdf>

### **SEC Releases Updated FAQ on Forms N-PORT, N-CEN**

- The SEC released updated FAQ guidance regarding investment company reporting modernization reforms as they relate to forms N-PORT and N-CEN.
  - The guidance clarified compliance dates for both forms, explaining that for form N-PORT, under the modified approach, rather than filing each month, larger entities (i.e., funds with net assets greater than or equal to one billion dollars) will maintain the information required to be included in Form N-PORT in their records until April 1, 2019. Smaller fund groups, however, are not required to prepare and maintain as a record the information required on Form N-PORT, and will now submit their first reports by April 30, 2020.
  - For Form N-CEN, the compliance date is June 1, 2018 for all funds and such funds must report within 75 days of the fund’s fiscal year end. A fund with a May 31 fiscal year-end would not need to make its first filing on Form N-CEN until the fiscal year ending May 31, 2019 (with such filing being made within 75 days of that date) because May 31, 2018 is prior to Form N-CEN’s compliance date.
  - For both Forms N-PORT and N-CEN, compliance should be based on reporting period end date.
- The FAQ can be found at: <https://www.sec.gov/investment/investment-company-reporting-modernization-faq#n-port>

## SEC Fund of Funds Rule – Rule Proposal

- The SEC proposed a new rule under the Investment Company Act of 1940 to streamline and enhance the regulatory framework applicable to funds that invest in other funds (“fund of funds” arrangements). The Release’s proposals are intended to replace the existing regime in order “to create a more consistent and efficient regulatory framework for fund of funds arrangements.”
- The proposing release can be found at: <https://www.sec.gov/rules/proposed/2018/33-10590.pdf>
- Comments are due on May 2.

## MiFID II

- Under EU law, MiFID II now requires that asset managers who obtain research from broker-dealers pay for research with their own funds and/or through a client-funded research payment account (“RPA”) alongside a separate payment for brokerage services. At the same time, U.S. law prevents broker-dealers from accepting cash payments for research without registering with the SEC as investment advisers, which many are reluctant to do for legitimate business reasons.
- In recognition of these issues, the SEC staff issued three no-action letters on October 26, 2017. The SIFMA Letter was time limited in nature for thirty months from the implementation date of MiFID II, or January 3, 2018.
- In December, SIFMA submitted a letter to the SEC requesting that the SEC provide immediate regulatory guidance so that firms have enough time to implement changes: “*However, regardless of how the SEC chooses to proceed, our immediate and perhaps more pressing concern relates to the temporary nature of the dealer’s no-action relief letter that was issued by the staff last fall. We believe it is critical for the staff to provide clarity quickly regarding whether it plans to issue extended and/or permanent relief. As discussed in our meeting earlier this fall, should the SEC decide not to extend the relief, industry participants will need time to implement the changes necessary to meet regulatory requirements currently stayed by the SEC’s temporary relief.*”

## SEC EXAM PRIORITIES AND GUIDANCE

### SEC Office of Compliance Inspections and Examinations Announces 2019 Examination Priorities

- On December 20, the SEC’s Office of Compliance Inspections and Examinations (OCIE) announced its 2019 examination priorities. This year, OCIE’s examination priorities are broken down into six categories: (1) compliance and risk at registrants responsible for critical market infrastructure; (2) matters of importance to retail investors, including seniors and those saving for retirement; (3) FINRA and MSRB; (4) digital assets; (5) cybersecurity; and (6) anti-money laundering programs.
  - **Compliance and Risks in Critical Market Infrastructure** – Examinations of firms, including clearing agencies, national securities exchanges, and transfer agents; focusing on certain aspects of their operations and compliance with recently effective rules.
  - **Retail Investors, Including Seniors and Those Saving for Retirement** – Focus on the disclosure and calculation of fees, expenses, and other charges investors pay, the supervision of representatives selling products and services to investors, broker-dealers entrusted with customer assets, and portfolio management and trading.
  - **FINRA and MSRB** – Focus on FINRA’s operations and regulatory programs and the quality of FINRA’s examinations of broker-dealers and municipal advisors. Examination of MSRB to evaluate the effectiveness of select operations and internal policies, procedures, and controls.
  - **Cybersecurity** – All examination programs will prioritize cybersecurity with an emphasis on, among other things, proper configuration of network storage devices, information security governance, and policies and procedures related to retail trading information security.
  - **Anti-Money Laundering Programs** – Focus to ensure firms are appropriately adapting their AML programs to address their regulatory obligations.



- While the priorities drive OCIE's examinations, the scope of any examination is determined through a risk-based approach that includes analysis of the registrant's operations, products offered, and other factors.
- "OCIE continues to thoughtfully approach its examination program, leveraging technology and the SEC staff's industry expertise," said SEC Chairman Jay Clayton. "As these examination priorities show, OCIE will maintain its focus on critical market infrastructure and Main Street investors in 2019."
- The SEC's press release and memorandum can be found at: <https://www.sec.gov/ocie/announcement/ocie-announces-2019-examination-priorities>

### **SEC Issues Risk Alert on Adviser Personnel's Use of Electronic Messaging**

- On December 14 the SEC's Office of Compliance Inspections and Examinations ("OCIE") issued a Risk Alert to share its observations from a recent exam initiative that focused on investment adviser personnel's use of electronic messaging for business purposes.
- Items highlighted include whether and to what extent advisers complied with the relevant rules, including Rule 204-2 (the "Books and Records Rule") and Rule 204-2(a)(11) (the "Advertisements Recordkeeping Rule") and whether advisers had adopted and implemented relevant policies and procedures to comply with their obligations under the rules.
- The risk alert can be found at: <https://www.sec.gov/ocie/announcement/ocie-risk-alert-electronic-messaging>

### **SEC Risk-Based Examination Initiatives Focused on Registered Investment Companies**

- The SEC's Office of Compliance, Inspections and Exams ("OCIE") is conducting a series of examination initiatives focused on matters relevant to certain registered investment companies.
- Key Areas: Examiners intend to focus on certain mutual funds and exchange-traded funds, the activities of their advisers, and boards of directors' oversight. Examinations will target circumstances in which retail investors could be disadvantaged and review whether registrants have met their regulatory and other legal obligations.
- The SEC Risk Alert can be found at: [https://www.sec.gov/files/OCIE%20Risk%20Alert%20-%20RIC%20Initiatives\\_0.pdf](https://www.sec.gov/files/OCIE%20Risk%20Alert%20-%20RIC%20Initiatives_0.pdf)

### **FINRA EXAMINATION FINDINGS AND PRIORITIES: FINRA 2018 Exam Findings**

- FINRA issued the report as another resource for firms to "strengthen their compliance programs and supervisory controls." Retail customer suitability was a key theme and FINRA focused on three areas of suitability and corresponding supervisory findings from recent FINRA examinations: overconcentration; excessive trading; and unsuitable variable annuity recommendations.
- FINRA are also highlighted findings from the targeted examination of volatility linked products; fixed income mark-up disclosure; reasonable diligence for private placements; and abuse of authority. Additional observations included: anti-money laundering; accuracy of net capital computations; liquidity; segregation of client assets; operations of professional registration; customer confirmations; DBAs and communications with the public; best execution; TRACE reporting; and market access controls.
- The full exam findings can be found at: [http://www.finra.org/sites/default/files/2018\\_exam\\_findings.pdf](http://www.finra.org/sites/default/files/2018_exam_findings.pdf)

### **FINRA's 2019 Risk Monitoring and Exam Priorities**

- FINRA's 2019 Risk Monitoring and Examination Priorities Letter identifies topics that FINRA will focus on in the coming year:
  - **Online Distribution Platforms** – Evaluation of how firms operate distribution of securities through online platforms, including how firms conduct their reasonable basis and customer-specific suitability analyses, supervise communications with the public and meet Anti-Money Laundering (AML) requirements.
  - **Fixed Income Mark-Up Disclosure** – Review of firms' compliance with their mark-up or mark-down disclosure obligations on fixed income transactions with customers pursuant to amendments to FINRA Rule 2232 (Customer Confirmations) and MSRB Rule G-15, which became effective in 2018.
  - **Regulatory Technology** – Understand how firms are using innovative regulatory technology (RegTech) tools and address related risks, challenges or regulatory concerns, including those relating to supervision and governance systems, third-party vendor management, safeguarding customer data and cybersecurity.



- The letter also notes other areas of focus:
  - **Sales Practice Risks** – This remains a top priority, including the protection of senior and retired investors; and assessment of firms’ controls related to associated persons’ outside business activities and private securities transactions.
  - **Operational Risks** – Firms’ digital assets business, as well as assess firms’ compliance with customer due diligence and suspicious activity reviews.
  - **Market Risks** – Best execution decision-making; focus on market manipulation and market access; and review short sales and short tenders for compliance with Exchange Act Rule requirements.
  - **Financial Risks** – Evaluation of firms’ funding and liquidity planning, as well as the firms’ policies and procedures for identifying, measuring and managing credit risk.
- FINRA reminded members that firms should expect FINRA to also focus on topics from past years. The letter can be found at: [http://www.finra.org/sites/default/files/2019\\_Risk\\_Monitoring\\_and\\_Examination\\_Priorities\\_Letter.pdf](http://www.finra.org/sites/default/files/2019_Risk_Monitoring_and_Examination_Priorities_Letter.pdf)

## RETIREMENT REGULATIONS

### *DOL: MEPs Proposed Rule*

- In connection with the August 31 Executive order, the DOL proposed a rule to expand access to retirement saving options for small businesses. The proposed regulation would allow different businesses to join a Multi-Employer Plan (“MEP”), either through a group or association or through a professional employer organization (“PEO”). Under the proposal, businesses in the same industry or geographic area would be eligible to join the same MEP. The proposal may affect banks, insurance companies, securities broker-dealers, record keepers, and other commercial enterprises that provide retirement-plan products and services.
- The rule proposal can be found at: <https://s3.amazonaws.com/public-inspection.federalregister.gov/2018-23065.pdf>

## *E-Delivery*

- At the very end of 2018 the “Receiving Electronic Statements to Improve Retiree Earnings (RETIRE) Act” (S. 3795) was reintroduced in the Senate. It would permit retirement plan sponsors to automatically enroll participants in electronic delivery for plan communications, while providing an opt-out option for employees who prefer to continue receiving paper documents. This is a companion bill to H.R. 4610. The text of S.3795 can be found at: <https://www.congress.gov/bill/115th-congress/senate-bill/3795/text>
- In addition, per an August 31 Executive Order, the DOL and Treasury have one year to review regulations and guidance to simplify and improve disclosures while reducing employer costs, including the “potential broader use of electronic delivery...”

## OTHER ITEMS

### *Depository Trust @ Clearing Corporation (“DTCC”) to Launch Centralized Communication Service*

- The DTCC launched a new, on demand, real time, centralized communications service for the mutual fund industry. The service was launched by DTCC’s Wealth Management Services Division in late 2018. The service, called MF Info Xchange, will help centralize the delivery and receipt of time-critical mutual fund notifications and alerts that usually require communications from funds to their intermediary partners. The service provides real-time notifications, automation of existing manual processes, and an event calendar for intermediaries to view important events.
- An overview of the offering can be found at: <http://www.dtcc.com/wealth-management-services/mutual-fund-services/mf-info-xchange>



## **SEC Proxy Process Roundtable**

- Bob Schifellite from Broadridge participated in the proxy “mechanics” panel. On November 15, the SEC held a roundtable to discuss the U.S. proxy process. Topics included: voting “mechanics” (end to end vote confirmation), shareholder proposal submission and resubmission thresholds, and the role of proxy advisor firms.
- SEC Chairman Jay Clayton stated the goal of any changes would be to benefit Main Street investors and emphasized the importance of the existing intermediary system: *“I do think we have to have respect for our intermediary system. It’s not just an intermediary system for ownership and voting, but it is also an intermediary system for trading. It adds to efficiencies and trade.”*
- Additional information about the roundtable, including the transcript and webcast, can be found at: <https://www.sec.gov/proxy-roundtable-2018>

## **FCC Establishes Reassigned Numbers Database – New Rules for Texting**

- On December 12, the FCC established a reassigned numbers data base. The rule requires voice and text providers to provide disconnected phone numbers to the database. Callers/textors will use the database to check whether a number still belongs to a particular consumer who has provided prior express consent to receive calls or texts.
- The FCC also adopted a safe harbor for callers/textors that rely on the database to learn if a phone number has been disconnected and potentially reassigned. The safe harbor is intended to protect good faith callers against database errors. To take advantage of the safe harbor, a caller would need to

show that the most recent update of the database reported inaccurately that a number had not been disconnected and the caller reasonably relied on that information when making a particular call or sending a text.

- The rule does not mandate when the database will be created. It is expected that the FCC will issue a bidding process to establish and run the reassigned number database.
- The FCC order can be found at: [https://thedcoffice.com/late-releases\\_files/12-13-2018/FCC-18-177A1.pdf](https://thedcoffice.com/late-releases_files/12-13-2018/FCC-18-177A1.pdf)

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