Regulatory Insights for Asset Managers, Mutual Funds and Retirement Firms

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SEC
Regulation Best Interest/Form CRS – SEC Adopts Final Rules and Interpretations

• On June 5, 2019, the SEC Commission voted to adopt Regulation Best Interest (“Reg BI”). The rulemaking package includes:
  – A new/heightened standard of care for broker-dealers (Best Interest)
  – A new retail disclosure document required to be delivered by broker-dealers and investment advisers to their clients at the beginning of the relationship or before a recommendation is made (Form CRS)
  – Interpretive guidance and clarification of the Fiduciary Duty for investment advisers under the Investment Advisers Act of 1940 (“advisers”)
  – Interpretive guidance on an exception from registration under the Advisers Act for broker-dealers to provide investment advice, if solely incidental to their brokerage business

• The rules apply to both retirement and non-retirement brokerage accounts, as well as for advisory accounts. Importantly, Reg BI will apply to discussions around rolling over assets from employer-sponsored retirement plans to IRAs.

• Compliance Period: There will be a one-year transition period for firms to come into compliance with the rules, deadline being June 30, 2020. The two interpretations of the Advisers Act became effective immediately upon publication in the Federal Register (7/12/19).


• Earlier this spring at SIFMA’s Annual Compliance and Legal Conference, Robert Colby, chief legal officer of the Financial Industry Regulatory Authority, Inc. ("FINRA"), said “Once the SEC measure is final, FINRA will review it and work to “fix” potential differences and inconsistencies. We’ll also look to see if there’s any reason for us to continue to have a separate suitability rule, because we’ll be enforcing Reg BI.”

• Status of state laws: Massachusetts, New Jersey and Nevada have proposed rules (as well as other states that are considering proposed rules) requiring broker-dealers to comply with a fiduciary duty of care.

• Separately, the DOL’s spring 2019 Reg Flex Agenda provided that they extended the expected timing for proposed rulemaking (as a result of their Fiduciary Rule being rescinded) to December, 2019.
Proxy Process

• Commissioner Roisman is leading efforts to develop recommendations to improve the process; focusing on proxy adviser firms, shareholder proposal thresholds and proxy mechanics. Roisman outlined his goals and approach earlier this year in a speech at the ICI’s Mutual Funds and Investment Management Conference: www.sec.gov/news/speech/speech-roisman-031819.

• On August 21, 2019 the SEC Commission adopted two proxy interpretive guidance releases:
  – Commission Interpretation and Guidance Regarding the Applicability of the Proxy Rules to Proxy Voting Advice (applicable to proxy adviser firm recommendations) www.sec.gov/rules/interp/2019/34-86721.pdf

• As a follow up to the SEC staff’s roundtable in November 2018, on July 16, 2019 the SEC’s Division of Corporation Finance held the first meeting in a series of discussions on proxy mechanics. The focus of these discussions was on end-to-end vote confirmation and the steps needed to implement it.

• The SEC’s Investor Advisory Committee (IAC) summer meeting on July 25, 2019 included a discussion on proxy mechanics. Although a vote was not taken, they discussed the recommendation from the Investor-as-Owner Subcommittee of the IAC. A public meeting has been scheduled for September 5, 2019 where the IAC is expected to vote on their recommendation, which includes four specific recommendations:
  – The SEC should require end-to-end vote confirmations to end-users of the proxy system, potentially commencing with a pilot involving the largest companies
  – The SEC should require all involved in the system to cooperate in reconciling vote-related information, on a regular schedule, including outside specific votes, to provide a basis for continuously uncovering and remediating flaws in the basic “plumbing” of the system
  – The SEC should conduct studies on (a) investor views on anonymity and (b) share lending
  – The SEC should adopt its proposed “universal proxy” rule, with the modest changes that would be needed to address objections that have been raised to that proposal

• The full recommendation can be found at: www.sec.gov/spotlight/investor-advisory-committee-2012/recommendation-investor-as-owner-subcommittee-proxy-plumbing.pdf

• Additional information from the November 15, 2018 proxy roundtable, including the transcript, webcast and industry comment letters, can be found at: www.sec.gov/proxy-roundtable-2018

The SEC’s Division of Investment Management provided their short- and long-term initiatives in the SEC’s 2019 Spring Regulatory Flexibility Agenda:

Short-Term Agenda:

• Proposed Rule State: Use of Derivatives by Registered Investment Companies and Business Development Companies; Amendments to the Marketing Rules Under the Advisers Act; Fund of Fund Arrangements; Offering Reform for Business Development Companies Under the Small Business Credit Availability Act and Closed-End Funds Under the Economic Growth, Regulatory Relief, and Consumer Protection Act; Amendments to the Custody Rules for Investment Companies and Investment Advisers; Amendments to Procedures for Applications Under the Investment Company Act

• Final Rule Stage: Exchange-Traded Funds; Enhanced Disclosure for Separate Accounts Registered as Unit Investment Trusts and Offering Variable Insurance Products; Form CRS Relationship Summary; Amendments to Form ADV; Required Disclosures to Retail Customers and Restrictions on the Use of Certain Names or Titles; Commission Interpretation Regarding Standard of Conduct for Investment Advisers; Request for Comment on Enhancing Investment Adviser Regulation

Long-Term Agenda:

• N-PORT Filing Extension; Stress Testing for Large Asset Managers and Large Investment Companies; Modernization of Investment Company Disclosure; Investment Company Summary Shareholder

• Link to full Long-Term Agenda-reginfo.gov/public/do/eAgendaMain?operation=OPERATION_GET_AGENCY_RULE_LISTS&currentPubId=201904&showStage=longterm&agencyCd=3235
Auditor Independence with Respect to Certain Loans or Debtor-Creditor Relationships

- The SEC Commission adopted amendments to the auditor independence rules to determine whether an auditor is independent when the auditor has a lending relationship with certain shareholders of an audit client at any time during an audit or professional engagement period.
- The amendments codify the temporary relief that the SEC provided in 2016 in the staff’s no-action letter regarding the application of the Loan Rule to an investment company complex.
- The amendments focus the analysis on beneficial ownership rather than on both record and beneficial ownership, replace the existing 10 percent bright-line shareholder ownership test with a “significant influence” test, add a “known through reasonable inquiry” standard with respect to identifying beneficial owners of the audit client’s equity securities, and exclude from the definition of “audit client,” for a fund under audit, any other funds that otherwise would be considered affiliates of the audit client under the rules for certain lending relationships.
- Compliance Date: The final rules are effective on October 3, 2019.
- The final amendments and release can be found at: www.sec.gov/rules/final/2019/33-10648.pdf

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 March, Director Blass raised the SEC’s 2017 no-action letters and said the staff is examining the issues and impact to the “many parties and interests involved,” and is looking at both regulatory and market solutions.

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FINRA RULEMAKING

Proposed Rule Change to Amend FINRA Rules 2210 (Communications with the Public) and 2241 (Research Analysts and Research Reports)

- Financial Industry Regulatory Authority, Inc. (“FINRA”) is filing with the Securities and Exchange Commission (“SEC” or “Commission”) proposed amendments to FINRA Rule 2210 (Communications with the Public) and FINRA Rule 2241 (Research Analysts and Research Reports) required by the Fair Access to Investment Research Act of 2017 (“FAIR Act”). The proposed rule change would eliminate the “quiet period” restrictions in Rule 2241 on publishing a research report or making a public appearance concerning a covered investment fund and would create a filing exclusion under FINRA Rule 2210 for covered investment fund research reports.
- The proposed rule filing can be found at: www.finra.org/sites/default/files/rule_filing_file/SR-FINRA-2019-017-federal-register-notice.pdf

RETIREMENT REGULATIONS AND LEGISLATION

DOL Expanding Multi-Employer Plans

- On July 29, 2019, the DOL finalized a rule expanding the use of multi-employer plans (MEPs). It falls short of “open MEPs,” which is currently included in the SECURE ACT, which passed out of the House in May and is pending in the Senate.
- On July 3, 2019, the IRS issued a notice of proposed rulemaking, which would effectively eliminate the ‘one bad apple’ rule – if certain requirements are met, MEPs would not be disqualified due to the actions of one plan sponsor member.
WATCH LIST

Variable Annuity and Variable Life Insurance Summary Prospectus Rule Proposal

• On October 30, 2018, the SEC proposed a summary prospectus rule for variable annuities and variable life insurance products. The rule proposal and industry comment letters can be found at: www.sec.gov/rules/proposed/2018/33-10569.pdf

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).

• In January, Broadridge launched a comprehensive solution that enables the capture of investor distribution preferences through a centralized website (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. This solution allows funds and broker-dealers to comply with the opt-out requirements of the rule and will help them begin sending notices at the earliest possible date in 2021.

• Twin River lawsuit to rescind 30e-3 – Twin River Paper Company, Consumer Action, the Paper Coalition and other entities filed suit in the DC Court of Appeals 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). On August 16, 2019, the court ruled that Twin River, paper advocates and consumer groups cannot advance their lawsuit to prevent Rule 30e-3 from going into effect. The court said that the plaintiffs failed to convey how their members would be overtly injured by its rule. The judges also decided that paper-industry representatives are not the intended targets of SEC rulemaking, and as a result, do not have standing to sue.

SEC Fund Disclosure and Fund Processing Fees Releases

• SEC’s Retail Investor Fund Disclosure Initiative: The SEC’s Division of Investment Management (IM) initiated a retail fund investor experience and disclosure initiative in 2018 and issued a request for comment in June, 2018. The Release and comment letters can be found at: www.sec.gov/comments/s7-12-18/s71218.htm

• Fund Processing Fees Release: Broadridge and other industry comment letters were filed on October 31, 2018. The SEC staff continues to digest comments and meet with industry groups on its Request for Comments. The Release and comment letters can be found at: www.sec.gov/comments/s7-13-18/s71318.htm#meetings

This is not intended as legal advice. We recommend you contact your legal counsel for a complete understanding of the information contained in this publication.