IAA NEWSLETTER

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INSIDE

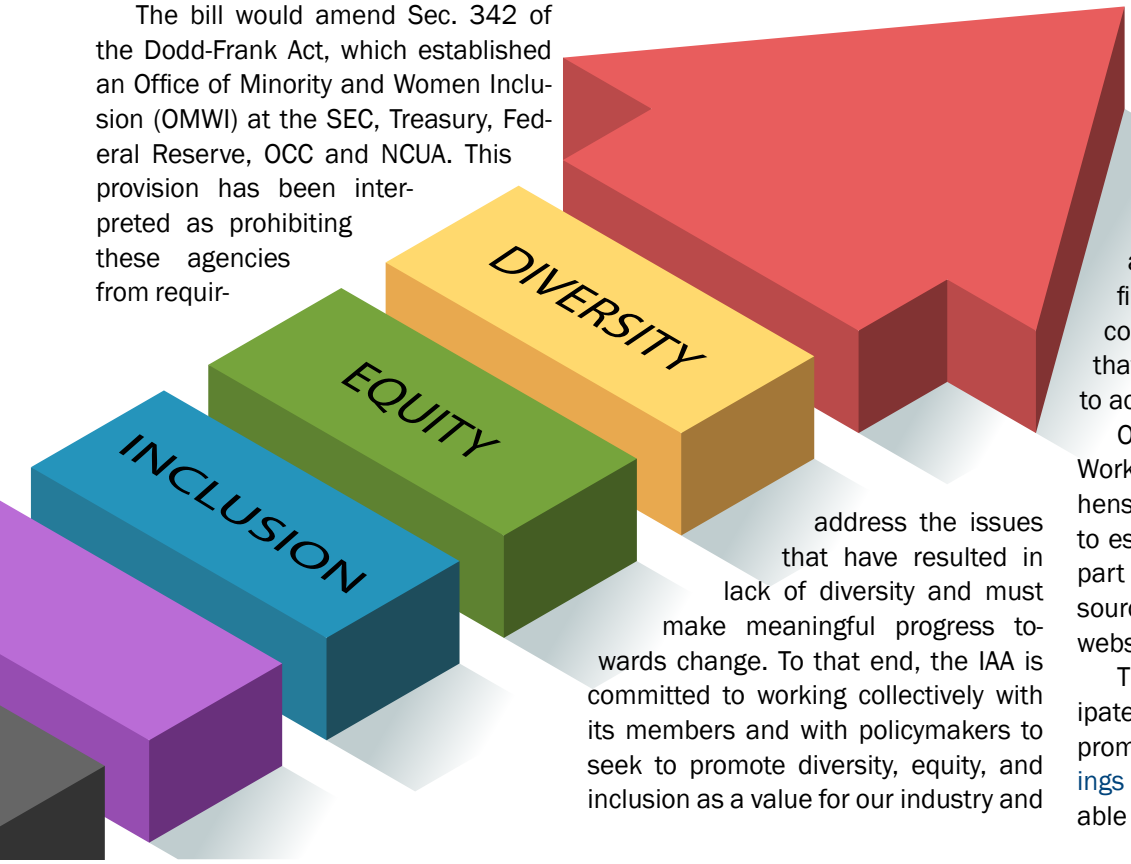
IAA Voices Strong Support for Legislation to Collect Data on Diversity, Equity and Inclusion

Posted to IAA Today on April 19, 2021

Recognizing that the investment adviser profession "has a long way to go in matters of diversity, equity, and inclusion," the IAA has voiced its strong support for the Diversity and Inclusion Data Accountability and Transparency Act, which has been favorably reported out of the House Financial Services Committee.

The bill would amend Sec. 342 of the Dodd-Frank Act, which established an Office of Minority and Women Inclusion (OMWI) at the SEC, Treasury, Federal Reserve, OCC and NCUA. This provision has been interpreted as prohibiting these agencies from requiring regulated entities to respond to their surveys on diversity. The bill would add a single sentence to Sec. 342 allowing these agencies to require that regulated entities with more than 100 employees provide diversity information to OMWI.

In a letter to Committee Chair **Maxine Waters** (D-Calif.) and Ranking Member **Patrick McHenry** (R-NC), IAA President & CEO **Karen Barr** said the investment adviser community "must address the issues that have resulted in lack of diversity and must make meaningful progress towards change. To that end, the IAA is committed to working collectively with its members and with policymakers to seek to promote diversity, equity, and inclusion as a value for our industry and to providing education, information, and resources to help foster significant progress.



"The ability to measure progress is critically important," Barr said in her letter. "For this reason, enactment of the Diversity and Inclusion Data Accountability and Transparency Act would constitute a significant foundational step in addressing diversity in the asset management industry. The IAA urges you and Committee members to support enactment of the Act."

The IAA, in partnership with the research firm Cerulli Associates, has conducted a survey to document progress toward and attitudes about diversity, equity, and inclusion at advisory firms. The final report, which will be released in coming days, will include action items that firms and their personnel can take to accelerate diversity in the industry.

Our Diversity, Equity, and Inclusion Working Group is producing a comprehensive guide for advisory firms to use to establish successful DE&I programs, part of a larger collection of online resources that will launch soon on the IAA website.

The IAA has also originated or participated in a number of presentations on promoting DE&I in the industry. Recordings of those presentations are available online.

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FROM THE PRESIDENT & CEO AND BOARD CHAIR

The IAA's New Strategic Plan – Turning up the Volume

By IAA President & CEO Karen Barr and Board of Governors Chair Chris Carsman

Posted to IAA Today on April 28, 2021

As our industry continues to grow and evolve, the IAA – as your voice, your resource, and your investment adviser community – must continue to grow and evolve with it. It is our mission to advance the interests of our industry, advocate for an effective and efficient policy environment, and provide the insight, intelligence, and connection that members need to serve their clients and grow their businesses. Now is the time for us to be bigger and bolder in that mission – "turning up the volume" on your voice and in all that we do.

To meet the challenge of today's environment and ensure that the IAA continues to provide value to our members and achieves strong growth going forward, our Board of Governors last month unanimously approved a strategic plan that establishes our association's priorities and goals for the next five years. The Board's action followed 18 months of review and identifies four key strategic goals: (1) strengthen the IAA's value proposition across key constituencies and member segments; (2) serve as the leading voice of and advocate for investment advisers; (3) increase and expand sources of revenue; and (4) raise our visibility.

Going forward, the IAA will elevate our voice on behalf of all fiduciary investment advisers, focusing less on technical descriptions of our membership (*e.g.*, SEC registration status). To that end, the Board has amended **the IAA's membership criteria** to welcome fiduciary investment advisers broadly, without unnecessary constraints in our membership criteria [*see notice* page 12]. While the IAA's policy goals and strategies will continue our focus on issues at the U.S. federal level, membership will also be available to non-U.S.-registered firms, state-registered firms, and more digital advisers, for example, as well as holding companies or other entities with a substantial ownership interest in advisers. To be clear, the change in membership criteria will not affect our policy priorities and core services.

Karen Barr
IAA President & CEO

Chris Carsman
IAA Board Chair
Senior Policy Advisor,
Affiliated Managers Group

"Going forward, the IAA will elevate our voice on behalf of all fiduciary investment advisers, focusing less on technical descriptions of our membership (e.g., SEC registration status)."

In addition to high level goals and strategies, the plan identifies priority activities and projects, including re-imagining delivering value to members in a **hybrid in-person/virtual world** and providing more opportunities for tailored **peer group interaction**. The strategic plan also incorporates a focus on enhanced resources and programs designed to assist members with **business management and operational issues** and engage a broader range of personnel at member firms. The plan specifically includes promotion of **diversity, equity, and inclusion** as a value and as a goal, consistent with the IAA's mission and purpose, and a long-term commitment to constructive action.

To support our robust platform of programs and advocacy, the strategic plan seeks to **bolster and diversify revenue** by growing our membership, expanding non-dues revenues including through strategic partnership programs, and reassessing current dues models. The plan aims to significantly **increase the visibility of the IAA**, our mission, and our value to members – to further strengthen our advocacy impact and membership growth, as well as **promote the value of fiduciary investment advice** and our profession. The IAA will prioritize and reinforce our advocacy and expand the use of strategic tools to increase our influence, impact, and prominence in the public affairs arena.

Finally, the plan recognizes the need to ensure that the IAA's infrastructure supports the strategies and goals identified going forward. To that end, the IAA will be devoting significant resources into improving our technology, for example, including a **new mobile-friendly website** with an updated design and enhanced functionality.

A summary of the new IAA strategic plan is presented on Page 11. We gratefully acknowledge the

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SEC Risk Alert Outlines ESG Exam Focus Areas, Related Deficiencies, Effective Compliance Practices

Posted to IAA Today on April 12, 2021

The SEC's Division of Examinations has issued a Risk Alert describing areas of focus in examinations of advisers and funds engaging in ESG investing, compliance deficiencies and weaknesses from recent examinations in this area, and examples of effective compliance practices. The Risk Alert highlights the increased investor demand for and growth in ESG investment products and services, and the different ways that firms approach ESG investing. The Risk Alert stresses that, with the lack of standardization in ESG definitions, portfolio management practices must be consistent with "disclosed ESG investing processes or investment goals."

Areas of Focus in Examinations: Examinations of advisers and funds that claim to engage in ESG investing focus on the following areas:

- ***Portfolio Management:*** The SEC will review "the firm's policies, procedures, and practices related to ESG and its use of ESG-related terminology; due diligence and other processes for selecting, investing in, and monitoring investments in view of the firm's disclosed ESG investing approaches; and whether proxy voting decision-making processes are consistent with ESG disclosures and marketing materials." This approach underscores that examinations will focus on the many steps of the investment process, and firms will need to show documentation for each stage of that process.

- ***Performance Advertising and Marketing:*** The SEC will review "the firm's regulatory filings; websites; reports to sponsors of global ESG frameworks, to the extent the firm has communicated to clients and potential clients a commitment to follow such frameworks; client presentations; and responses to due diligence questionnaires, requests for proposals, and client/investor-facing documents, including marketing materials." The Risk Alert includes examples of frameworks, but the Division does not take a position "with respect to the merit or efficacy" of any particular framework. Advisers should note that, although the SEC does not require advisers to adhere to a specific ESG framework, once an adviser states that it is following a particular framework, it is clear from the Risk Alert that the SEC will review the adviser's compliance, communications, and disclosures in connection with that framework. The Risk Alert also includes a reference to the recently adopted Advisers Act Marketing Rule.

- ***Compliance Programs:*** Finally, the SEC will review "the firm's written policies and procedures and their implementation, compliance oversight, and review of ESG investing practices and disclosures."

Areas of Compliance Deficiencies and Weaknesses: The Risk Alert discusses the following areas of compliance deficiencies and weaknesses from examinations of advisers, registered funds, and private funds that engage in ESG investing:

- ***Inconsistency between Portfolio Management Practices and Disclosures:*** The Division found portfolio management practices that differed from disclosures in Form ADV Part 2A, advisory agreements, offering materials, responses to requests for proposals, and due diligence questionnaires. Specific examples of issues include:

  — "[L]ack of adherence to global ESG frameworks where firms claimed such adherence"; and

  — "[F]und holdings predominated by issuers with low ESG scores – as measured, for example, by a sub-adviser's proprietary internal scoring system – where such predominance appeared inconsistent with those firms' stated approaches."

- ***Inadequate Controls Related to Clients' ESG-Related Directives:*** These directives include clients' or funds' ESG-related investing guidelines, mandates, and restrictions. The Risk Alert notes inadequate controls for implementing, monitoring, tracking, and updating clients' directives, particularly where directives are "ill-defined, vague, or inconsistent." In some cases firms had "contrary marketing claims touting processes for implementing clients' positive screens."

- ***Proxy Voting Inconsistent with Advisers' Public Statements:*** Proxy voting is a topic that has been raised recently by the SEC in connection with ESG investing. Examples of deficiencies in this area are public statements by firms that:

  — "ESG-related proxy proposals would be independently evaluated internally on a case-by-case basis to maximize value, while internal guidelines generally did not provide for such case-by-case analysis"; and

  — Clients may "vote separately on ESG-related proxy proposals," but clients were not provided that opportunity, and firms did not have related compliance policies.

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SEC Risk Alert Outlines ESG Exam Focus Areas—*continued from page 4*

- ***Misleading Claims Regarding ESG Approaches:*** The Risk Alert provides the following examples of misleading claims:

  — "[U]nsubstantiated claims by advisers regarding their substantial contributions to the development of specific ESG products" when "their roles were very limited or inconsequential"; and

  — Marketing materials for ESG funds "that touted favorable risk, return, and correlation metrics related to ESG investing" but that did not disclose "significant expense reimbursement" from fund sponsors, which inflated fund returns.

- ***Inadequate Controls for Consistency Between Disclosures/Marketing and Firm Practices:*** Specific examples of inadequate controls in this area include:

  — "[L]ack of adherence to global ESG frameworks despite claims to the contrary";

  — "[U]nsubstantiated claims regarding investment practices (*e.g.,* only investing in companies with 'high employee satisfaction')";

  — "[A] lack of documentation of ESG investing decisions and issuer engagement efforts"; and

  — Not updating marketing materials to reflect, for example, if an adviser stopped offering an ESG product or service.

- ***Compliance Programs Not Adequately Addressing ESG Issues:*** The Risk Alert highlights the need for compliance programs to address all stages of ESG investing, disclosure, and communications. Specific areas of weakness in compliance programs include how firms:

  — Adhere to global ESG frameworks;

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This complimentary Active Managers Council webinar gives advisers a clear path forward for educating clients about the role of active investments in portfolio plans and provides practical strategies for practical conversations about investor expectations. Speakers are **Natixis Advisors** Portfolio Manager **Jack Janasiewicz** and Natixis Center for Investor Insight Executive Director **Dave Goodsell**.

The webinar recording is available online.

— Obtain "reasonable support for ESG-related marketing claims";

— Oversee sub-advisers that focus on ESG; and

— Encounter difficulties in "supporting claims made to clients that each fund investment had received a high score for each *separate* component of ESG…when relying instead on *composite* ESG scores provided by a sub-adviser (emphasis added)."

The Risk Alert notes that compliance programs are less effective when compliance personnel have limited knowledge of ESG investing or limited oversight of related disclosures and marketing.

Fortunately, the Risk Alert also highlights the following **effective practices** observed on examinations:

- ***Clear, Precise Disclosures Tailored to Firms' Specific ESG Approaches that are Aligned with Firms' Actual Practices:***

  — The Risk Alert includes the following examples of "simple and clear disclosures" regarding ESG investing approaches:

    o Prominent statements by advisers that "their ESG investing approach involved relying on unaffiliated advisers to conduct the underlying ESG analysis and allocating client assets among ESG-oriented mutual funds managed by those unaffiliated advisers"; and

    o Disclosures "where clients were offered choices among standardized portfolios focused on particular ESG issues, or alternatively, customized separately managed accounts designed to accommodate particular client preferences";

  — "Clear and prominent" disclosures that firms can satisfy global ESG framework requirements "while making investments that appeared to be inconsistent with ESG investing"; and

  — Explanations of how investments are evaluated using global ESG frameworks and how firms approach those frameworks.

- ***Policies and Procedures that Address ESG Investing:*** The Risk Alert notes that some firms' policies and procedures include "specific documentation to be completed at various stages of the investment process (*e.g.,* research, due diligence, selection, and monitoring)." Where a firm uses multiple ESG investing approaches at the same time, the Risk Alert discusses the benefits of "specific written procedures, due diligence documentation, and separate specialized personnel."

- ***Compliance Personnel Knowledgeable About Specific ESG-Related Practices:*** The Risk Alert again discusses the benefits of compliance personnel who are knowledgeable about ESG. This knowledge enables "more meaningful reviews" of disclosures and marketing materials and the ability to assess and test ESG-related policies and procedures. Knowledgeable compliance personnel are also well-positioned to review the alignment of portfolio management processes with a firm's stated ESG investing approach, and test the firm's adherence to clients' investment preferences.

The IAA recently established an ESG Committee for members to help guide our advocacy efforts in this area and to provide a forum for member consideration of ESG-related policy, regulatory, and compliance issues. Please contact Associate General Counsel Sarah Buescher at sarah.buescher@investmentadviser.org if you are interested in joining the committee.

See The Division of Examinations' Review of ESG Investing (Apr. 9, 2021).

As Policy Debates Intensify, IAA Launches New ESG Committee

Members Will Help Guide IAA Engagement with Policymakers

Posted to IAA Today on April 8, 2021

To ensure that the interests of investment advisers are protected and advanced in ongoing ESG and Climate policy debates, the IAA has established an ESG Committee to help guide our advocacy efforts and to provide a forum for member consideration of ESG-related policy and regulatory issues more generally.

As investors' interest in sustainable, or ESG, investing has increased, so has the number of advisers engaging in ESG investing strategies and considering ESG factors as an integral part of a prudent investment process. ESG has become a high priority for the SEC, which has taken a flurry of related actions in recent weeks, and for other regulators. The IAA plans to be actively engaged in related policymaking efforts with the help of members on the committee.

The new ESG Committee will be chaired by **Heidi Hardin**, Executive Vice President and General Counsel of MFS Investment Management. **Carlotta King,** General Counsel and Corporate Secretary of Diamond Hill Capital Management, will serve as Vice Chair.

Heidi Hardin, MFS Investment Management

Carlotta King, Diamond Hill Capital Management

The committee will focus primarily on U.S. regulatory efforts, and it will also provide opportunities for members to discuss implementation of international regulations, including the European Commission's disclosure regulation, or SFDR, which went into effect on March 10 and is the first highly substantive ESG regulation to take effect.

One of the first items on the agenda for the ESG Committee will be SEC Acting Chair **Allison Herren Lee**'s request for comment on corporate climate change disclosures, discussed in *IAA Today*.

Other SEC moves to elevate ESG and Climate issues include the establishment of a dedicated Enforcement Task Force; a Division of Corporation Finance staff review of climate-related disclosures; identifying climate and ESG risks as top examination priorities; the appointment of a Senior Policy Advisor on Climate Change and ESG; and the issuance of an Investor Bulletin that focuses on ESG principles and provides information on ESG funds and their investment strategies. And the CFTC recently established a new Climate Risk Unit.

The IAA has issued a formal position paper on ESG investing opposing actions by regulators that would limit the ability of investment advisers to consider sustainability factors or pursue sustainable investment strategies on behalf of their clients.

Please contact IAA Associate General Counsel Sarah Buescher at sarah.buescher@investmentadviser.org if you are interested in joining the ESG Committee.

From the President & CEO and Board Chair—*continued from page 3*

outstanding contributions of the Strategic Planning Committee for their work in developing the strategic plan: **Geoff Alexander** (R. M. Davis), Co-Chair; **Richard R. Hough, III** (Silvercrest Asset Management), Co-Chair; **Rick Adler** (Red Arrow Capital); **Ben Alden** (Vanguard); **Alison E. Baur** (Franklin Templeton); **Yvette M. Garcia** (Bessemer Trust); and **Christine Morgan** (T. Rowe Price).

We are proud of our accomplishments in serving the interests of our members and our profession, and we look forward to strengthening our role as an industry leader in the years ahead.

As always, we are grateful for your ongoing support and welcome your feedback.

Karen Barr
IAA President & CEO

Chris Carsman
IAA Board Chair
Senior Policy Advisor, Affiliated Managers Group

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INVESTMENT ADVISER ASSOCIATION

DOL Issues FAQs for Firms, Guidance for Investors on Fiduciary Exemption

DOL Anticipates Amending Fiduciary Exemption, Other Exemptions, and ERISA Investment Advice Fiduciary Regulation

Posted to IAA Today on April 16, 2021

Less than two months after allowing the Department of Labor's new Fiduciary Exemption to take effect, the DOL's Employee Benefits Security Administration (EBSA) has issued a set of frequently asked questions (FAQs) on the exemption. An *IAA Today* article discussing the exemption is available here. This exemption covers only non-discretionary advice, so its primary application to advisers providing discretionary management likely will be with respect to rollovers.

Ali Khawar, Acting Assistant Secretary of Labor for Employee Benefits, said in a press release that the FAQs "provide assistance to financial institutions and investment professionals as they ramp up compliance with the exemption." The FAQs in some cases repeat what the DOL said in the preamble to the exemption.

- ***Background and Compliance Dates:*** The DOL explains why it adopted the exemption, which became effective on **February 16, 2021**. To provide a transition period for firms to comply with the exemption, DOL Field Assistance Bulletin 2018-02 will remain in place until **December 20, 2021**. The bulletin includes a non-enforcement policy for investment advice fiduciaries that work diligently and in good faith to comply with the DOL's Impartial Conduct Standards. The DOL's updated interpretation of the five-part test for determining when a recommendation is investment advice went into effect on February 16, 2021, the same time as the Fiduciary Exemption. That updated interpretation includes the revocation of the so-called Deseret Letter, which treated rollover recommendations as non-fiduciary conduct. Under the updated interpretation, a rollover recommendation is fiduciary investment advice under ERISA if the five-part test is satisfied.

- ***Future Updates to Exemptions and Regulations:*** The DOL is not delaying the effectiveness of the Fiduciary Exemption because it "believes that core components of [the exemption], including the Impartial Conduct Standards and the requirement for strong policies and procedures, are fundamental investor protections which should not be delayed while the [DOL] considers additional protections or clarification." The DOL "anticipates taking further regulatory and sub-regulatory actions, as appropriate, including amending the investment advice fiduciary regulation, amending [the Fiduciary Exemption], and amending or revoking some of the other existing class exemptions available to investment advice fiduciaries."

- ***Definition of Fiduciary Investment Advice:*** The DOL notes that the five-part test defining fiduciary investment advice under ERISA "extends to the entire advice relationship and does not exclude the first instance of advice, such as a recommendation to roll plan assets to an IRA, in an ongoing advice relationship." Regarding the use of disclaimers to avoid fiduciary status, the DOL cautions that "[b]oilerplate disclaimers are insufficient to defeat the test, when the parties have a mutual understanding that the adviser is making an individualized recommendation upon which the investor can be expected to rely in making the investment decision."

- ***Compliance with the Fiduciary Exemption:*** Many FAQs discuss conditions to the exemption, including the following:

  — ***Written acknowledgement of fiduciary status:*** The DOL includes the model language from the preamble as "language that will satisfy the fiduciary acknowledgement requirement."

  — ***Written description of financial institution's and investment professional's material conflicts of interest:*** Examples of conflicts include those "associated with proprietary products, payments from third parties, and compensation arrangements for both the financial institution and individual investment professional." The DOL explains that the disclosure "should be designed to allow a reasonable person to assess the scope and severity of the financial institution's and investment professional's conflicts of interest." In the preamble to the exemption, the DOL said that financial institutions may rely on other regulatory disclosures, such as Form CRS and Form ADV to satisfy certain aspects of this disclosure requirement.

  — ***Consideration and documentation of the reasons that a rollover recommendation is in an investor's best interest:*** In considering alternatives to a rollover,

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IAA ADVISER ADVOCACY DAY

THURSDAY, JUNE 10, 2021
VIRTUAL EVENT

Making Advisers' Voices Heard on Capitol Hill

A new Administration and a new Congress mean a new focus on a wide range of issues affecting investment advisers – ESG, a financial transaction tax, carried interest, changes to capital gains, advisory fee deductibility, asset manager diversity, new disclosure mandates, e-delivery, retirement changes, and more.

How debate on these issues progresses – and how legislation on these issues is developed – will have lasting impact on advisory firms and their clients, so it's crucial that we make our voices heard on Capitol Hill. Legislators say the voices they listen to most closely are those of their constituents – which is why it's critically important that you join us for our 2021 Adviser Advocacy Day on **Thursday, June 10**.

Participation is free, but advance registration is required.

REGISTER NOW

How Our Virtual Program Works

Unlike previous years when we visited legislators' offices in person, this year's Adviser Advocacy Day will take place virtually. Attendees will be grouped and matched with legislators based on their work address and can expect to participate in three to five virtual meetings with lawmakers and/or their staffs, which will take 15-20 minutes each.

One week in advance, you will gain access to our Adviser Advocacy Day portal that includes:

- Your schedule
- Zoom links to all meetings
- Talking points and brief position papers on priority issues
- Industry economic and employment data for your state
- Contact information for attendees in your meetings

For Sponsorship Opportunities: Contact Alex Ioannidis at alex.ioannidis@investmentadviser.org.

the DOL explains that firms and investment professionals should also consider the investor's other investment options in the plan. Cost is another consideration, and the DOL explains that that analysis should include, among other factors, "the long-term impact of any increased costs" and "why the rollover is appropriate notwithstanding any additional costs."

— ***Policies and procedures to mitigate conflicts of interest:*** The DOL believes that financial institutions should "eliminate or mitigate incentives that are misaligned with the interests of their customers and that they adopt and implement effective oversight structures." Examples of conflicts for financial institutions include those related to "proprietary products and limited menus of investment options that generate third party payments (*e.g.,* revenue sharing arrangements)." For financial professionals, the DOL warns against using "quotas, bonuses, prizes, or performance standards" that encourage recommendations that are not in investors' best interest.

- ***Annual Retrospective Review:*** The DOL emphasizes that senior executive officers must carefully review the written report of the annual retrospective review before making the required certifications, and that "[m]aking the certifications without carefully reviewing the report would constitute a violation of the exemption."

- ***Enforcement:*** The FAQs conclude with a discussion of how the DOL will enforce compliance with the Fiduciary Exemption. For ERISA plans, the DOL will investigate for compliance with the exemption. For IRAs and non-ERISA plans, the DOL "has interpretive authority to determine whether the exemption conditions have been satisfied and transmits information to the IRS for enforcement of the excise tax." The DOL also explains how parties may become ineligible to rely on the Fiduciary Exemption.

Investor Publication: The DOL also issued a publication for investors that includes questions to ask investment advice providers, and commentary on those questions.

See New Fiduciary Advice Exemption: PTE 2020-02, Improving Investment Advice for Workers & Retirees, Frequently Asked Questions (April 2021), Choosing the Right Person to Give you Investment Advice: Information for Investors in Retirement Plans and Individual Retirement Accounts (April 2021), and US Department of Labor Releases Guidance on Investment Advice Exemption.

DOL Issues First Ever Cybersecurity Guidance

Posted to IAA Today on April 16, 2021

The DOL's Employee Benefits Security Administration (EBSA) has issued its first ever cybersecurity guidance to help plan sponsors, fiduciaries, and record keepers protect plan participants and assets from both internal and external cyber risks. The guidance is contained in three separate documents:

- **Cybersecurity Program Best Practices** for plan fiduciaries "making prudent decisions on the service providers they should hire" and for plan record keepers and other service providers "responsible for plan-related IT systems and data." The best practices include:

  — A formal, well documented cybersecurity program;

  — Prudent annual risk assessments;

  — A reliable annual third party audit of security controls;

  — Clearly defined and assigned information security roles and responsibilities;

  — Strong access control procedures;

  — Appropriate security review and independent security assessments for assets or data stored in a cloud or managed by a third party service provider;

  — Cybersecurity awareness training conducted at least annually for all personnel and updated to reflect risks identified in the most recent risk assessment;

  — Secure System Development Life Cycle (SDLC) Program;

  — A business resiliency program that effectively addresses business continuity, disaster recovery, and incident response;

  — Encryption of sensitive data;

  — Strong technical controls implementing best security practices; and

  — Responsiveness to cybersecurity incidents or breaches.

The guidance discusses each best practice and identifies elements of prudently designed programs.

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Executive Summary: IAA's Five-Year Strategic Plan

Posted to IAA Today on April 16, 2021

On March 24, 2021, following an 18-month review assessing the evolving industry landscape and association operations, the IAA Board of Governors unanimously adopted a new five-year strategic plan to ensure that the IAA continues its critical current work while laying the foundation for achieving enhanced value to members and strong growth going forward.

The strategic plan reaffirms the IAA's core mission. As part of its assessment, the Board determined to emphasize the IAA's voice on behalf of fiduciary investment advisers, focusing less on SEC registration in its messaging and removing unnecessary constraints from its membership criteria. The most critical levers identified as part of the strategic assessment process were an emphasis on public affairs and communications, infrastructure, expanded sources of revenue, and segmented offerings.

The Association has identified four strategic goals that are clearly interdependent in order to achieve this vision, as well as specific priority activities to support each strategic objective. The IAA will engage in a branding effort as an overlay to the success of these strategic goals:

1. Strengthen the IAA's value proposition across key constituencies and member segments
2. Serve as the leading voice of and advocate for investment advisers
3. Expand and strengthen sources of revenue to support key goals and initiatives
4. Raise the visibility of the IAA both externally and internally

IAA Purpose
To serve the interests of the investment advisory profession.

IAA Mission
To be the leading industry organization:

- Promoting high standards of fiduciary duty, integrity, public responsibility, and competence in the investment advisory profession.
- Providing effective, quality representation of the investment advisory profession with respect to the development, formulation, and enactment of legislation, regulations, and other policies relating to investment advisers.
- Offering benefits, services, and resources that assist and add value for member firms.

GOAL 1: Strengthen the IAA's value proposition across key constituencies and member segments

The IAA will strengthen and expand our service offerings by identifying and developing additional quality programs, reaching across a variety of member organizational functions and levels, to support the current member base as well as to anticipate the needs of the future generation of members. We will increase and deepen member engagement by providing high value leadership, networking and educational opportunities. We will promote diversity, equity, and inclusion as a value and as a goal, consistent with the IAA's mission and purpose, and a long-term commitment to constructive action.

The IAA will re-imagine delivering value to members in a hybrid in-person/virtual world and providing more opportunities for tailored, segmented peer group interaction, including piloting invitation-only member personnel groups. The strategic plan also incorporates a focus on enhanced resources and programs designed to assist members with business management and operational issues and website and technology investment to enhance members' virtual engagement experience.

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DOL Issues First Ever Cybersecurity Guidance—*continued from page 10*

- **Tips for Hiring a Service Provider with Strong Cybersecurity Practices**, designed for plan sponsors. These tips include questions to ask service providers.
- **Online Security Tips** for plan participants and beneficiaries to help reduce the risk of fraud and loss in retirement accounts.

See Cybersecurity Program Best Practices, Employee Benefits Security Administration, Tips for Hiring a Service Provider with Strong Security Practices, and Online Security Tips.

GOAL 2: Serve as leading voice of and advocate for investment advisers

The IAA has been impactful in advancing the interests of the investment adviser community and has established itself as a well-respected leader on policy issues affecting investment advisers. The IAA will maintain and further develop our advocacy and related activities with policymakers and regulators to ensure that key legislative and regulatory agendas and outcomes address members' most important issues. We will prioritize educating the public and policymakers about the value of investment advisers, fiduciary advice, active management, and the importance of investment advisers to investors, the markets, and the economy.

The IAA will reinforce our advocacy strengths by expanding our strategic tools to increase our influence, impact, and prominence in the public affairs arena, further strengthening key relationships with policymakers and regulators; raising grassroots member involvement; increasing donations to IAA PAC; and serving as the go-to source for industry data, trends, and analysis for policymakers and regulators.

GOAL 3: Expand and strengthen sources of revenue

The IAA will bolster and diversify revenues by (1) growing the net number of members through focused member recruitment by target market, improved member retention, and other strategies; (2) expanding non-dues revenue, including through strategic partnership programs; and (3) reassessing current dues models for both regular and associate members.

The plan includes fostering deeper engagement by associate members and partners; creating bespoke programs with key partners; expanding sponsorship packages; offering advertising and sponsored content on the IAA website and in the IAA newsletters; co-branding with partners; and exploring opportunities to create new revenue streams leveraging existing IAA expertise.

GOAL 4: Raise the visibility of the IAA both externally and internally

The IAA will significantly increase the visibility of the Association's mission and value to members, potential members, policymakers, the public, and other identified constituents through the use of external communications tools, including robust public relations. We will enhance the credibility of the IAA as the voice of fiduciary investment advisers, including through new branding activities.

The IAA will make strategic investments in infrastructure to enhance our internal and external-facing presence. To that end, the IAA will be devoting significant resources into improving our technology, including a new mobile-friendly website with an updated design and enhanced functionality. We will continue to strengthen our engagement through social media, our website, and the media.

Notice of Revised IAA By-Laws

On March 24, 2021, the IAA Board of Governors approved revised by-laws, which amend two provisions governing membership. The revision states that regular membership is open to any investment adviser firm or other legal entity that has a significant ownership interest in an investment adviser firm and that meets such other requirements as the Board prescribes. The revision also eliminates a redundant and outdated provision regarding evidence to be provided with an application. By resolution dated March 24, 2021, the Board established the following regular membership criteria: (1) investment adviser firm is duly registered in or regulated by the relevant jurisdiction; (2) is a fiduciary investment adviser; and (3) endorses the IAA Standards of Practice; or (4) is an entity that has a significant ownership interest in a firm meeting the above three requirements.

The revised by-laws are available on the IAA website. Any member firm that would like to receive a hard copy of the by-laws or further information about the amendments should contact the IAA at iaaservices@investmentadviser.org or (202) 293-4222. For more information about this by-law amendment, please read this issue's From the President & CEO and Board Chair column on page 3.

Five Tips for Staying Ahead of Changing Cyber, Privacy Rules

Posted to IAA Today on April 7, 2021

"There is a tremendous amount of activity," stressed **Kirk Nahra** of WilmerHale. "We've seen almost an annual seismic shift in privacy law. It's becoming a much more challenging issue."

Nahra was speaking at the 2021 IAA Investment Adviser Compliance Conference in a session addressing *Cybersecurity and Data Privacy*. The session also included panelists **Keith Cassidy** of the SEC's Division of Examinations, **Tess Macapinlac** of OneTrust, and **Tim Villano** of Artemis Global Security.

The panelists reviewed the rapidly evolving cybersecurity and data privacy environment. Here are their top tips for how investment advisers can stay one step ahead:

Be prepared for more legislation. "We are now seeing more and more states start to look at passing [data privacy] laws," noted Nahra. "We now have the second significant privacy law in the state of Virginia," following California's lead. The key issue is whether Virginia "becomes a motivator for other states," he added.

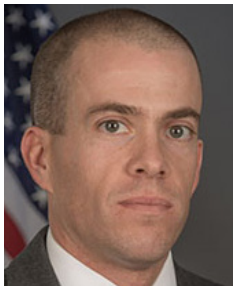
"The major driver of timing of a national privacy law will be what happens in the states," Nahra predicted. Once three to five states have passed their own privacy laws in addition to California, "industry will have to coalesce support around a national law and push for it," though he noted that "the baseline for a national law rises with each state law."

There's a good chance that financial services would be covered by this new federal legislation, predicted Nahra. While the industry might prefer to continue to be governed by the existing Gramm-Leach-Bliley rules, Congress may be concerned about leaving financial services consumers with less protection than other consumers. In other words, Nahra cautioned, "leave us alone" may not be a viable lobbying position for the industry.

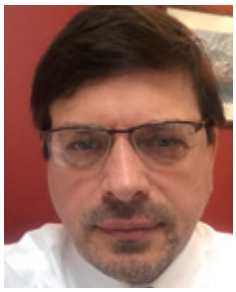
Tap into the SEC's expertise. Looking to stay ahead of cyber threats? The SEC's Division of Examinations can provide insights on best practices, explained Cassidy, who is the head of the Division's Technology Controls Program. This nationwide program has 40 staff and contractors based in Washington, DC, New York and Chicago focused exclusively on cybersecurity and technology.

The program has published risk alerts and reports that summarize the results of examinations and "provide[s] information to registrants about how to improve their operations." Cassidy summarized three publications issued in 2020: the July 2020 risk alert on ransomware, the September 2020 risk alert on safeguarding client accounts against credential compromise, and the January 2020 report on cybersecurity and resiliency.


Kirk Nahra, WilmerHale


Keith Cassidy, SEC


Tess Macapinlac, OneTrust


Tim Villano, Artemis Global Security

An additional risk alert on cyber issues is likely in 2021, said Cassidy. The Division is currently working on the "Cyber 3" initiative which is looking at how registered investment advisers are protecting non-public personal information and how they are preparing for cyberattacks, with a particular focus on advisers with multiple offices or that have recently merged. He anticipates that they will publish a new risk alert based on the results of this initiative.

Step up vendor due diligence. The SolarWinds hack has highlighted the

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importance of vendor due diligence, stressed IT security consultant Villano. SolarWinds was a "supply chain breach that was executed by state actors conducted on a professional time frame," he explained. The malware inserted into the SolarWinds Orion network management tool was merely a means to an end – namely, attacks on companies using that tool, especially in a Microsoft environment.

The lesson for investment advisers is that they need to ask hard questions of managed service providers. "What kind of updating is done on their tool set? Do you have any control over the updating process? Can you use a delayed channel in updating critical applications?" are all questions that can help an adviser assess a vendor's cyber preparedness.

Create a data inventory. Understanding "what data do you have, and how long do you have it" is the foundation for any privacy program, explained Macapinlac. A complete inventory will note where each piece of information is physically stored, to help assess which laws are applicable, and it should also include data held by vendors.

This inventory can help ensure that firms "collect the least amount of data possible and use if for the purpose intended," she noted. It can also help manage overlapping privacy laws by identifying common data points. For example, both California's CPRA and Europe's GDPR talk about "sensitive personal information" (though the definitions vary somewhat). A data inventory that separates this "sensitive" information from other personal information can focus compliance efforts.

Integrate privacy from the start. And what about firms that aren't subject to any compliance laws . . . at least not yet? "Get started now," advised Macapinlac. Privacy is "entangled in every department," she explained, noting that the most successful compliance efforts are the ones that "integrate privacy from the start."

All Eyes on ESG – Plus Tips for Implementing an ESG Program

Posted to IAA Today on April 5, 2021

It seems that everyone is focused on ESG investing these days – investors, the SEC and regulators in the European Union.

At the 2021 IAA Investment Adviser Compliance Conference, **Anthony Eames** of Calvert Research and Management, **Sean Murphy** of EIG Global Energy Partners, and **Bob Toner** of William Blair Investment Management talked about the challenges created by all this attention. They spoke in a panel session titled *ESG Investing and Implementation,* which was moderated by **Gwen Williamson** of Perkins Coie.

Focus for investors. The panelists agreed that there's a growing interest in ESG investing from a wide range of investors. Toner said that interest is generally greatest among institutional investors in Europe – to such an extent that having an ESG approach is a "gating issue" for investment advisers wishing to serve these clients. Murphy agreed that Europe is "more advanced than other regions," while noting interest is picking up in other regions, such as Asia.

There's been a shift in sentiment in the United States as well. "Some of this is generational," suggested Eames, with younger investors more focused on environmental and social factors than the older generation.

However, there has also been a shift in approach, he added. In the past, Eames explained, "responsible investing was a way for values investors to express their beliefs in their portfolios. Today . . . the growth is with traditional or profit-seeking investors" who see ESG factors as material to their investment success.

Anthony Eames, Calvert Research and Management

Sean Murphy, EIG Global Energy Partners

Bob Toner, William Blair Investment Management

Focus for the SEC

The new administration at the SEC has quickly made ESG a priority, said Williamson. In fact, in the past few weeks:

- Then-Acting Chair **Allison Herren Lee** announced that the Division of Corporation Finance will review public company filings for compliance with the SEC's 2010 interpretive guidance on the disclosure around climate change. The Division will also review and update that guidance.

- The SEC's Office of Investor Education and Advocacy issued a bulletin for investors on ESG investing, focusing on the lack of standardization in ESG data and in ESG practices among asset managers.

- In his confirmation hearings, new SEC Chair **Gary Gensler** testified on Capitol Hill that he would support a rulemaking on climate risk disclosure and

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potentially other ESG-related issues.

- The Division of Examinations announced that it would prioritize ESG-related issues in 2021 exams, focusing on investment adviser disclosure and business continuity planning for climate change-related events.

- The SEC created an Enforcement Task Force on climate and ESG issues.

And "we are likely to see more," warned Williamson.

"It's long overdue," argued Eames. "The world has really changed."

With regard to the examination priorities, however, the focus is "consistent with the past few years," said Murphy. "The SEC is making sure that you're practicing what you're preaching."

Even so, his firm is making sure that they're prepared for increased scrutiny. "We'll be doing a gap analysis of our ESG-related policies and procedures as compared against our marketing materials," said Eames. "That's a good first step."

Focus for EU regulators

By contrast to the incremental steps being taken in the United States, regulators in the European Union have taken a "sweeping" approach that is "designed to encourage ESG investing and discourage exaggeration and greenwashing," explained Williamson.

Starting this March, under new rules known as the Sustainable Finance Disclosure Regulation (SFDR), asset managers, insurers and pension funds must disclose the sustainability risks in their portfolios.

These rules require that managers categorize their funds into three groups along the ESG spectrum. Funds that are classified as "sustainable investments" or that "promote environmental or social characteristics" are subject to additional requirements.

"At a high level, it's a pretty complicated regime," noted Murphy. His firm's first step was to understand "if we're in scope and, if so, which products are in scope," adding that having products marketed in the EU is one of the "triggering factors."

The EU regulators are "laser focused on environmental issues," cautioned Toner. Funds that want to be categorized as "sustainable investments" will need to think about their environmental impact, he added.

Top Tips for Implementing an ESG Program

Considering establishing an ESG program at your firm? The panelists in the ESG Investing and Implementation session had the following tips:

1. **Focus on the data.** "Sourcing the best data and making sure that it's decision useful information" is essential, stressed **Anthony Eames** of Calvert Research and Management. "Each data provider has its own view on materiality," and there's relatively low correlation across providers, he explained, noting that Calvert uses a dozen providers in its investment effort.

2. **Be realistic.** Some strategies are "tough to fit" into an ESG framework, cautioned **Bob Toner** of William Blair Investment Management, citing sovereign bond and macro strategies as two examples. Lack of disclosure is an issue in some asset classes, such as municipal bonds, high yield bonds and bank loans, added Eames.

3. **Engage with your investors.** Have an "ongoing discussion" with investors and prospective investors, recommended **Sean Murphy** of EIG Global Energy Partners, to make sure that you stay on top of changes in investor sentiment. For example, not long ago, natural gas stocks were a standard holding in environmentally-conscious energy portfolios, but today the focus is on zero-carbon companies.

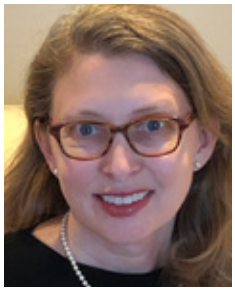
4. **Consider the interplay between firm and product.** Firms must decide whether they should have a product-specific approach or a firm-level approach, noted Murphy, depending on the diversity of their product set. Either approach can raise conflict issues, he added, so "make clear what you're doing."

5. **Be sincere.** Investment advisers wanting to get involved with ESG "need to do it sincerely . . . comprehensively, holistically," stressed Eames. They should think about how engagement, including proxy voting, aligns with their investment approach. "It's an important part of the narrative," he noted.

High Tech in High Finance I SEC's FinHub, Compliance Automation

Posted to IAA Today on April 19, 2021

As in other industries, technological change is driving innovation in asset management. At the 2021 IAA Investment Adviser Compliance Conference, a breakout session titled *Adapting Technology to Achieve Compliance Efficiency and Results* addressed the SEC's support for technology initiatives and the use of tech tools in compliance monitoring.


Jennifer McHugh, SEC

The SEC's **Jennifer McHugh** talked about the Commission's Strategic Hub for Innovation and Financial Technology – better

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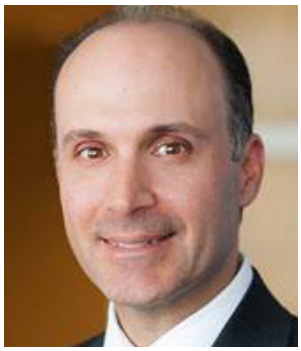
LIBOR Transition: Important Recent Developments

Thomas D'Ambrosio, Partner, Morgan, Lewis & Bockius LLP

Posted to IAA Today on April 19, 2021

Background. 2021 has been a busy year so far for the transition away from LIBOR. On March 5, 2021 the United Kingdom's Financial Conduct Authority (FCA) confirmed that all LIBOR settings will either cease to be provided by an administrator or no longer be representative (i) immediately after December 31, 2021 in the case of all sterling, euro, Swiss franc and Japanese yen settings, and the 1-week and 2-month U.S. dollar settings, and (ii) immediately after June 30, 2023, in the case of the remaining U.S. dollar settings. That confirmation by the FCA had the effect of crystalizing the relevant dates for the cessation of the applicable LIBORs and propelling the financial industry toward preparing for such events. The FCA's confirmation also had the effect of constituting an **index cessation event** under the International Swaps and Derivatives Association, Inc. (ISDA) IBOR Fallbacks Supplement and protocol, triggering a fixing of the fallback spread adjustment on the date of the FCA's announcement. Also, on April 6, the governor of New York State signed into law a bill designed to address U.S. dollar LIBOR transition for legacy contracts that mature after June 30, 2023 and do not have effective reference rate fallbacks. (See related article in the IAA Legal & Regulatory Update Column.) This Compliance Corner will discuss these recent developments and what advisers should consider in the coming months.



Thomas D'Ambrosio, Partner, Morgan, Lewis & Bockius LLP

"Advisers should understand that the ISDA fallback triggers will apply if the adviser has adhered to the ISDA 2020 IBOR Fallbacks Protocol and will also apply to the extent the current version of the 2006 ISDA Definitions are utilized, whether or not the adviser has adhered to such protocol."

U.K. FCA. Although the FCA had previously indicated that LIBOR would be discontinued after December 2021, there was some uncertainty as to whether rates would continue to be published even though those rates might not be representative, and there was a lack of clarity as to what would happen with respect to some of the more ubiquitous settings of LIBOR. In its March 5 statement, the FCA clearly announced the future cessation or loss of representativeness of the 35 LIBOR benchmark settings currently published by ICE Benchmark Administration (IBA), an authorized administrator regulated and supervised by the FCA. In that confirmation, the FCA stated that it would not require any panel banks to continue to make LIBOR submissions beyond the dates from which the banks notify the administrator of their departure from the submission process. The FCA also stated that it would not require the IBA to continue to publish LIBOR on the basis of panel bank submissions beyond such dates. Addressing the issue of "synthetic" LIBOR (*i.e.,* a LIBOR rate that is published using a different methodology from the submission process that is currently used to produce such LIBOR rate), the FCA stated that it currently has no intention to use its powers to compel the IBA to continue to publish any of the following 26 LIBOR settings based upon a synthetic basis after the following dates:

- Publication of all 7 euro LIBOR settings, all 7 Swiss franc LIBOR settings, the Spot Next, 1-week, 2-month and 12-month Japanese yen LIBOR settings, the overnight, 1-week, 2-month and 12-month sterling LIBOR settings, and the 1-week and 2-month U.S. dollar LIBOR settings will cease immediately after December 31, 2021 with no subsequent synthetic basis publication.

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- Publication of the overnight and 12-month U.S. dollar LIBOR settings will cease immediately after June 30, 2023 with no subsequent synthetic basis publication.

The FCA may gain additional powers from the United Kingdom Parliament to require the publication of certain LIBOR settings on a synthetic basis. If those additional powers are granted, then the FCA will consult on requiring the IBA to continue to publish on a synthetic basis the 1-month, 3-month and 6-month sterling LIBOR settings for a further undefined period after the end of December 2021, and the 1-month, 3-month and 6-month Japanese yen LIBOR settings after the end of December 2021 for one additional year. The FCA does not envision compelling the IBA to continue to publish any Japanese yen LIBOR settings after the end of December 2022, and, absent notice to the contrary, publication of these settings will cease permanently immediately after a final publication on December 30, 2022. The FCA will continue to consider the case for requiring continued publication on a synthetic basis of the 1-month, 3-month and 6-month U.S. dollar LIBOR settings for a further period after June 30, 2023, taking into account views and evidence from the U.S. regulators and other stakeholders. Even if the foregoing LIBOR settings are published on a synthetic basis, however, the synthetic settings will not be representative from the dates earlier specified above for cessation.

The FCA's statements on March 5, 2021 engage certain contractual triggers for the calculation and future application of fallbacks that are activated by pre-cessation or cessation announcements made by the FCA. One of the most important fallback triggers are those contained in documentation published by ISDA, which cover over-the-counter derivative transactions including interest rate products that utilize LIBOR rates. Advisers should understand that the ISDA fallback triggers will apply if the adviser has adhered to the ISDA 2020 IBOR Fallbacks Protocol and will also apply to the extent the current version of the 2006 ISDA Definitions are utilized, whether or not the adviser has adhered to such protocol. The fallback rates that will apply differ with respect to each LIBOR. With respect to U.S. dollar LIBOR, the fallback reference rate will be the term adjusted **Secured Overnight Financing Rate (SOFR)** plus the spread relating to U.S. dollar LIBOR for the relevant maturity as provided by Bloomberg Index Services Limited. While derivative contracts using ISDA documentation will now automatically adjust from LIBOR to the relevant rate, cash investments in which advisers may invest on behalf of clients will not necessarily adjust in the same manner or at the same time. Consequently, advisers should carefully consider the universe of their cash investments, whether any adjustments to these instruments need to be consistent with any adjustments of the adviser's derivative contracts, and how and when such cash investments may adjust.

"While derivative contracts will now automatically adjust from LIBOR to the relevant rate, cash investments that advisers may invest in on behalf of clients will not necessarily adjust in the same manner or at the same time."

New York State. Subsequent to the actions of the FCA, on April 6, 2021, the governor of New York State signed a bill into law which became effective immediately and adds new Article 18-C to the New York General Obligations Law. The purpose of the law is to provide a statutory solution for legacy contracts that reference U.S. dollar LIBOR as a benchmark interest rate but do not include appropriate fallback provisions if the U.S. dollar LIBOR rate is no longer published or is no longer representative. The law states that if the applicable contract contains no fallback provisions or contains fallback provisions that reference U.S. dollar LIBOR, then the replacement SOFR rate, including the applicable spread adjustments that are necessary to convert the U.S. dollar LIBOR rate to SOFR, that is recommended by the appropriate recommending body or regulatory authority (*i.e.,* the Federal Reserve Board, Federal Reserve Bank of New York or the Alternative Reference Rates Committee) will be the replacement rate for the contract. Importantly, under the law, neither the cessation of U.S. dollar LIBOR nor the use of the replacement rate will have the effect of (i) discharging or excusing performance under the relevant contract for any reason, including, but not limited to, any force majeure provision in any relevant contract; (ii) giving any person the right to unilaterally terminate or suspend performance under any relevant contract; (iii) constituting a breach of any relevant contract; or (iv) voiding or nullifying any relevant contract. Under the law, the selection or use of a recommended benchmark replacement rate or the determination, implementation, or performance of any technical, administrative or operational changes, alterations or modifications that are associated with and reasonably necessary to the use, adoption, calculation or implementation of a recommended benchmark replacement rate (collectively referred to as Conforming Changes) is not considered to be an amendment or modification of the relevant contract and does not prejudice, impair or affect any person's rights, interests or obligations under the relevant contract. The law also limits liability for parties who are involved with the substitution of the U.S. dollar LIBOR rate. Under its provisions, no person will have any liability for damages to any person

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or be subject to any claim or request for equitable relief arising out of or related to the selection or use of a recommended benchmark replacement rate or the determination, implementation or performance of the Conforming Changes, and such selection or use of the recommended benchmark replacement rate or such determination, implementation or performance of the Conforming Changes will not give rise to any claim or cause of action by any person in law or in equity. While this new law provides some much needed comfort to market participants, it is not a complete solution. The law does not apply to contracts that are not governed by New York law or that reference a LIBOR rate other than U.S. dollar LIBOR.

U.S. Securities and Exchange Commission. The Securities and Exchange Commission staff has and continues to encourage advisers to proactively manage the transition away from LIBOR, including determining their exposure to contracts and transactions that refer to LIBOR and establishing appropriate systems and procedures that work with the new replacement reference rates.

"Now that the FCA has spoken, the ISDA fallbacks are in effect and New York law has been amended to provide some relief, advisers should consider whether any additional gaps exist in managing the transition away from LIBOR on behalf of their clients."

Now that the FCA has spoken, the ISDA fallbacks are in effect and New York law has been amended to provide some relief, advisers should consider whether any additional gaps exist in managing the transition away from LIBOR on behalf of their clients.

**Thomas D'Ambrosio is a partner with Morgan, Lewis & Bockius LLP, where he concentrates in the area of derivatives and structured products. Mr. D'Ambrosio can be reached at (212) 309-6964 or* thomas.dambrosio@morganlewis.com.

This article is for general information purposes and is not intended to be and should not be taken as legal or other advice.

TAKEAWAYS—*continued from page 15*

known as FinHub. McHugh is the Division of Investment Management's delegate to FinHub.

FinHub is a "one stop shop" for "people outside the SEC who are interested in offering a new technology-based product or understanding the regulatory implications of serving as a robo-adviser or incorporating a new form of artificial intelligence into their investment selection process or marketing process," McHugh explained.

"A lot of the people who come to [FinHub for advice] come from a coding background," she added. "They're technology providers first; they speak a lot of engineering speak."

FinHub has four areas of focus:

- digital marketplace financing
- blockchain / distributed ledger technology
- automated investment advice
- artificial intelligence / machine learning

Since FinHub was launched in 2018, much of the focus has been on blockchain and digital assets, McHugh explained. However, an area that has gotten increasing attention in the past year is digital marketplace financing or "DFi," which replaces traditional financing with "programmatic, technology-based access to capital," she added.

In December 2020, FinHub became a stand-alone office in the SEC, reporting to the Chair, signaling its growing importance in the industry and the regulatory landscape.

In the same session, **Alex Gavis** of Fidelity discussed his firm's initiatives in compliance technology or "complitech." "We've been looking at this area quite a bit," he explained.

In the robotics area, automated bots can now scan a workflow database for expired content, escalating them for additional review. "Rather than have a human go through the database, we can have a bot go through the database, and that's a good control," he noted. Similarly, bots can monitor email traffic, looking for messages that include account information or unencrypted Social Security numbers.

Alex Gavis, Fidelity

A machine learning module can help identify complaints for faster processing. "The module learns over time what complaint language looks like," Gavis said.

Augmentation technology can help with communications and advertising review, he continued. This technology can do a "first pass" review that flags issues for the compliance reviewer. "That also can work for individuals who may be creating the content in the first place," he noted.

SEC Withdraws Certain COVID Relief for Funds, Issues Report on Prime Money Market Fund Activity at Onset of Pandemic

Posted to IAA Today on April 27, 2021

The SEC's Division of Investment Management is terminating an exemptive order and withdrawing two no-action letters that were issued in March 2020 as part of the SEC's response to the COVID-19 pandemic, effective April 30, 2021.

The order provided a set of exemptions for short-term funding for open-end funds and insurance company separate accounts. One of the no-action letters permitted affiliated persons of a money market fund to purchase securities from the fund. The other permitted affiliated persons that are not funds to purchase debt securities from a fund. The SEC continues to provide relief from the in-person fund board meeting requirement, which the IAA supports.

The Division has also issued an analysis of prime money market funds at the onset of the pandemic during a period of significant market volatility in March 2020. The analysis uses information filed by money market funds on Form N-MFP and describes cash flows, liquidity buffers, and volatility in net asset value (NAV) of these funds. Publicly offered prime institutional money market funds had the most outflows during March 2020. The data "did not show any apparent relationship between the level of the funds' NAV per share and outflows in the third week of March 2020."

See Division of Investment Management Staff Statement Regarding Termination Notice for Exemptive Relief and Withdrawal of Staff Letters Related to COVID-19 Response (Apr. 16, 2021); and Prime MMFs at the Onset of the Pandemic: Asset Flows, Liquidity Buffers, and NAVs (Apr. 15, 2021).

SEC Reopens Comment Period on Universal Proxy Proposal, Considers Application to Closed-End Funds and BDCs

Posted to IAA Today on April 27, 2021

The SEC has reopened the comment period for a proposal to require universal proxy cards in connection with certain contested director elections. A universal proxy card includes the names of all duly nominated director candidates, including candidates from company management and candidates from shareholders.

Typically, shareholders receive two proxy cards in a contested election, one from company management and another from shareholders who nominated alternate candidates, but shareholders cannot use both cards to vote. The SEC issued a proposal on universal proxy in October 2016. In announcing the reopening of the comment period, then-Acting SEC Chair **Allison Herren Lee** said these rules "will facilitate clarity and efficiency for shareholders voting in director elections."

The SEC is seeking comments on the 2016 proposal and additional questions included in the reopening release. The SEC explains in the reopening release that there has been an increase in contested elections of directors for registered closed-end funds and business development companies (BDCs) and it is considering whether the proposed rules should apply to those funds and BDCs. Open-end funds typically do not have contested elections, but the reopening release also includes questions about open-end funds. Comments are due 30 days after publication in the *Federal Register*.

See SEC Reopens Comment Period for Universal Proxy (Apr. 16, 2021).

IAA Responds to SEC Staff Request for Comment on Investment Company Cross Trading Rule 17a-7

Posted to IAA Today on April 13, 2021

IAA members today engage in cross trading between client accounts (*i.e.,* selling a security from one client account while purchasing that same security for another) as a cost-effective way to manage their client portfolios. Advisers that engage in cross trades involving mutual funds they manage must comply with their fiduciary duty to each of the clients involved in the transaction as well as with all conditions under Cross Trading Rule 17a-7 under the Investment Company Act.

The IAA has submitted comments to the SEC recommending amendments to modernize the Cross Trading Rule in response to the Division of Investment Management's staff statement on March 22. The staff statement recognizes that new guidance in the SEC's recent Valuation Rule 2a-5 (valuation release) would limit cross trading between funds to trades in Level 1 securities under the U.S. GAAP fair value hierarchy and therefore severely restrict the currently approved practice of cross trading in fixed income securities that may be Level 2. The statement seeks input on a range of questions related to how to amend Rule 17a-7.

The IAA urges the SEC to amend Rule

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17a-7 to (i) recognize that an adviser's fiduciary duty and controls to address conflicts of interest create appropriate principles-based safeguards to protect fund shareholders with respect to cross trades, (ii) permit cross trades of Level 2 securities and modernize the methods by which a fund can obtain an "independent current market price," while continuing to protect fund shareholders, and (iii) codify current no-action relief related to a board's review of a fund's chief compliance officer certification of compliance with Rule 17a-7. The SEC has included amendments to Rule 17a-7 on its fall 2020 regulatory agenda.

New York Adopts LIBOR Law, Effective Immediately

Posted to IAA Today on April 13, 2021

New York's long anticipated legislation to discontinue use of the London Inter-Bank Offered Rate (LIBOR) was signed into law on April 6 and is effective immediately.

The New York law tracks the legislative action proposed by the Federal Reserve Bank of NY and its Alternative Reference Rates Committee (ARRC). It provides that, for contracts, securities, or instruments governed by New York law that use LIBOR as a benchmark and that do not include provisions for another benchmark, once LIBOR is discontinued, the benchmark will become the "recommended benchmark replacement," which is based on the Secured Overnight Financing Rate (SOFR). Parties may, however, agree, prospectively or retrospectively, to a different non-LIBOR-based rate and elect not to have the New York law apply.

The New York law prohibits the parties to an agreement from declaring a breach or refusing to perform as a result of another party's selection of a recommended benchmark replacement. The law also provides a safe harbor from liability for the use of the recommended benchmark replacement.

The new law applies to contracts governed by New York law. It remains to be seen whether this development will encourage other states to follow suit.

The SEC in its 2021 examination priorities highlighted the Division of Examinations' intention to focus on firms' preparations for the end of LIBOR and the transition to an alternate reference rate.

SEC Investment Management Withdraws, Modifies Staff Letters to Implement New Derivatives Rule

Posted to IAA Today on April 13, 2021

The SEC Division of Investment Management has announced in an Information Update that it is withdrawing or modifying over 30 SEC staff letters or statements relating to Sections 12(a) and 18 of the Investment Company Act, for purposes of implementing the SEC's new Derivatives Rule under the Investment Company Act. The staff's actions will be effective as of the August 19, 2022 compliance date for the rule.

The Derivatives Rule, adopted by the SEC on November 2, 2020, permits registered investment companies and business development companies to enter into derivatives and certain other transactions, notwithstanding the restrictions under Sections 18 and 61 of the Investment Company Act, provided that they comply with certain conditions.

See Division of Investment Management Staff Statement Regarding Withdrawal and Modification of Staff Letters Related to Rulemaking on the Use of Derivatives and Certain Other Transactions by Registered Investment Companies and Business Development Companies (March 2021).

SEC Staff Issues FAQ on Mutual Fund Calculation Methodologies for Securities Lending Reporting

Posted to IAA Today on April 27, 2021

The staff of the SEC's Division of Investment Management recently updated its FAQs on Form N-CEN. New FAQ 7 identifies examples of methodologies a fund could use to calculate the "monthly average of the value of portfolio securities on loan" and the "monthly average net assets during the reporting period" in response to Items C.6.f and C.19.a, respectively, on Form N-CEN.

The two Items provide information about the use of, and potential risks associated with, a mutual fund's securities lending activities. The FAQ notes that while "a range of calculation methodologies with respect to the reporting on these Items could provide a reasonable representation of a fund's activities," the staff "believes that calculating [these Items] in a consistent manner will help promote comparability of data and better facilitate the use of the information reported on Form N-CEN."

The April 21 update is available online.

SEC's "Dear CFO" Letter Discusses Combined Financial Statements Under Custody Rule, Includes Updates to Reflect Fund Valuation, Derivatives Rules

Posted to IAA Today on April 5, 2021

The Chief Accountant of the SEC's Division of Investment Management has issued a "Dear CFO Letter" to assist funds, advisers, and their independent public accountants "in addressing certain accounting, auditing, financial reporting, or other related disclosure matters."

The Division also issued an updated Accounting Matters Bibliography. Several updates withdraw or modify prior statements to reflect the recently adopted fund valuation rule and fund derivatives rule.

One of the updates modifies a position taken by the SEC staff in 2020 on the issues that advisers should consider in whether to prepare combined financial statements for multiple pooled investment vehicles (PIVs). The

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update includes several specific considerations. The staff also states that advisers should consider "whether a combined presentation would be more meaningful than a stand-alone presentation and whether an individual investor could reasonably interpret the information presented on a combined basis to the investor's ownership in a specific PIV."

See From the Chief Accountant to the Division of Investment Management: Industry Comment Letter (Mar. 30, 2021) and Accounting Matters Bibliography.

Spotlight on SPACs: SEC Staff Highlight Issues Around Merging with SPACs, UK to Issue Consultation on Listing Standards

Posted to IAA Today on April 2, 2021

As SPACs – special purpose acquisition companies that acquire private companies and take them public – continue to increase in popularity, with around 522 new SPACs listed in 2020 and 2021 in the United States, the SEC's Division of Corporation Finance and Acting Chief Accountant have issued statements outlining issues that a private company needs to consider before merging with a SPAC.

The statements describe the many requirements that public companies are subject to, including financial reporting, internal controls, and exchange listing standards, and the Division of Corporation Finance's statement also lists restrictions on shell companies. The Acting Chief Accountant emphasizes the need for target companies to have a plan in place to address these regulatory requirements and also discusses the need for corporate board oversight of these business combination transactions. Regulators across the pond are also putting SPACs under a microscope, with the UK's Financial Conduct Authority announcing that it will conduct a four-week consultation on changes to its listing rules for SPACs to "ensure that SPACs operate within a framework of high regulatory standards and oversight."

See Staff Statement on Select Issues Pertaining to Special Purpose Acquisition Companies (Mar. 31, 2021), Financial Reporting and Auditing Considerations of Companies Merging with SPACs (Mar. 31, 2021), and Future consultation on strengthening investor protections in Special Purpose Acquisition Companies (SPACs).

NFA Announces September 30 Effective Date for New Third-Party Service Providers Oversight Requirement

Posted to IAA Today on April 13, 2021

The National Futures Association (NFA) has announced in a Notice to Members that Interpretive Notice 9079 - NFA Compliance Rules 2-9 and 2-36: Members' Use of Third-Party Service Providers (Interpretive Notice) governing outsourcing will become effective on September 30, 2021.

The Interpretive Notice reminds NFA members that, "[t]o mitigate the risks associated with outsourcing, a Member must have a written supervisory framework over its outsourcing function." It establishes a set of general requirements while recognizing that NFA members have flexibility in the adoption of a supervisory framework.

The general requirements include an initial risk assessment, onboarding due diligence, ongoing monitoring, termination, and recordkeeping. The Interpretive Notice notes that members that have an existing supervisory framework over their outsourcing activities are not required to design and implement a new framework. Instead, they should review their current policies and procedures and make any modifications necessary to meet the general requirements. Members are also reminded that they are responsible for complying with NFA and CFTC requirements, even if a violation is caused by a third-party service provider.

See NFA Notice to Members Notice I-21-13 (March 24, 2021), and NFA Interpretive Notice 9079 - NFA Compliance Rules 2-9 and 2-36: Members' Use of Third-Party Service Providers (March 24, 2021). The NFA Board approved the new requirements on February 18, 2021, and they were approved by the CFTC thereafter.

FSOC Meeting Focuses on Hedge Funds, Mutual Funds, Impact of Climate Change on Financial Stability

Posted to IAA Today on April 9, 2021

The Financial Stability Oversight Council's (FSOC's) first meeting of the year – and of the new Administration – focused on hedge funds, mutual funds, and climate change.

Following a discussion of the activities of hedge funds during the period of market volatility in March 2020 and recent market developments, Treasury Secretary **Janet Yellen**, who chairs FSOC, announced that FSOC's Hedge Fund Working Group will reconvene to enhance data sharing among agencies and to improve FSOC's "ability to identify, assess, and address potential risks to financial stability related to hedge funds."

SEC staff also provided an update on mutual fund performance, outflows, and liquidity risk management during the COVID-19 crisis. Yellen asked staff to "assess potential financial stability risks" associated with mutual funds, with a focus on liquidity risks.

The open session of the meeting included a presentation by Federal Reserve Board staff on climate change and its potential impact on financial stability and a discussion of actions by the FSOC agencies to address climate change risks.

See Readout of Financial Stability Oversight Council Meeting on March 31, 2021.

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SEC IAC Focuses on Minority and Underserved Inclusion, Discusses Self-Directed IRAs, SPACs

Posted to IAA Today on April 16, 2021

The SEC's Investor Advisory Committee's (IAC's) March meeting issued draft recommendations on minority and underserved inclusion in investment and financial services, calling on the SEC to "play an active role in the effort to close the wealth gap in our country." The meeting also featured panels on self-directed IRAs and Special Purpose Acquisition Companies (SPACs).

The draft recommendations on minority and underserved inclusion find an overlap between the SEC's tripartite mission and the recommendations' goal to increase traditionally underserved populations' access to capital and investments. One of the IAC's main recommendations in this regard calls for a review of previous and future regulations that may have unintended impacts on minority communities. The other recommendations focus on partnering with historically black colleges and universities (HBCUs) and outreach by SEC regional offices to expand investments by underserved communities and improve financial literacy. On a similar note, the recommendations call for the SEC to support programs that assist financial services firms in providing services to under-represented communities. SEC Commissioner **Elad Roisman** in particular voiced support of the agency's efforts towards building a regulatory regime that better addresses the interests of underserved communities and minority retail investors.

The panel on self-directed IRAs discussed plans for auto-portability of individual IRAs and the creation of a centralized database to track and consolidate new employer plans and small IRA accounts. These programs are intended to decrease the number of abandoned accounts and provide a method for retirement accounts to move with the account holder for continued investment. The state regulators on the panel spoke on Illinois' IRA program, which offers access to retirement savings for workers without an employer program, and on fraud associated with self-directed IRA accounts, with one speaker observing that custodians should be required to disclose their awareness of fraudulent schemes. There was also discussion about the need for increased legislative action to better protect investors from fraud, particularly with regard to their self-directed IRAs. SEC Commissioner **Hester Peirce**, however, raised concern about the overuse of regulation for self-directed IRAs as potentially harmful to investors.

Regarding SPACs, panelists discussed their experiences in researching and participating in SPACs as well as areas for improvement. Panelists agreed that there has been a large increase in the number of SPAC transactions taking place. While some panelists opined that SPACs can cost twice as much as traditional IPO transactions, panelists also noted that SPACs have increased value creation in public markets. It was recommended that the SEC create more consistent regulations for all issuing transactions, including SPACs, IPOs, and direct listings, to prevent gaps in investor protections. Commissioners Peirce, Roisman, and **Caroline Crenshaw** all voiced an interest in the SEC protecting investors from a lack of disclosure from SPACs and the need for more information about this area of rapid growth.

See Draft Recommendations regarding Minority and Underserved Inclusion in Investment and Financial Services (Mar. 5, 2021), and Draft Recommendation of the Market Structure Subcommittee of the SEC Investor Advisory Committee regarding Credit Rating Agencies (Mar. 4, 2021).

SEC's AMAC Discusses ESG, Diversity & Inclusion, and Private Funds

Introduces New Subcommittees on Smaller Advisers, Evolution of Advice

Posted to IAA Today on April 2, 2021

The SEC's Asset Management Advisory Committee's (AMAC's) March meeting covered several topics that are high on the SEC's policy agenda – ESG, diversity and inclusion, and private investments – and introduced two new agenda items for 2021 – issues for smaller advisers and funds and the evolution of advice. The meeting also provided an opportunity for the SEC's Acting Chair and Commissioners to signal their own priorities on these and other issues relating to asset management.

Acting Chair **Allison Herren Lee** reiterated the need for the SEC to focus on ESG, noting that the views of the ESG Subcommittee will help shape the SEC's views regarding ESG disclosure. In his remarks, Commissioner **Elad Roisman** posed several questions for asset managers regarding ESG, including whether they understand investors' objectives in this area, what specific information is needed from issuers, and why comparability is important. Commissioner **Hester Peirce** listed many other potential issues of concern to asset managers, including the need to modernize SEC rules on custody and cross-trading, state privacy laws, digital assets, and market structure. Commissioner **Caroline Crenshaw** also raised other potential issues for the AMAC to consider, including relating to securities lending and whether funds that lend securities "operate with sufficient safeguards" to mitigate associated risks, and the tradeoff between securities lending and proxy voting. She welcomed recommendations on revising Form N-PX, the form used by registered funds to report proxy votes.

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ESG Subcommittee

The AMAC's ESG Subcommittee heard from both issuers and asset managers at this meeting. The issuer panel focused on whether there is a need for specificity when describing ESG and the challenges arising from creating or using standardized ESG disclosures, *e.g.*, from the Task Force on Climate-related Financial Disclosures (TCFD) and/or the Sustainability Accounting Standards Board (SASB). One of the panelists noted, for example, that her company had to seek outside advice for some elements of TCFD reporting and that the SASB standards are useful because they can be catered to specific industries. Another panelist described his organization's work on creating a template of ESG information for industry members. Finally, one panelist conveyed her concerns that ESG disclosures may be unrelated to shareholder value and that focusing on objectives other than shareholder value could put American companies at a global competitive disadvantage.

The second discussion featured representatives from asset managers who discussed their firms' approaches to ESG consideration. Panelists addressed how sustainability risks are assessed as a component of corporate risks, strategy, and governance, the benefits of using industry-specific approaches to assess ESG, the importance of global solutions to ESG disclosure to avoid parallel disclosure frameworks, and the need for flexibility in developing ESG standards and for a level playing field between public and private companies. Several of the panelists agreed that it would be beneficial for the SEC to provide a safe harbor for issuers in connection with ESG disclosure requirements.

Diversity & Inclusion Subcommittee

In her opening remarks, Acting Chair Lee asked how the SEC can ensure that investors receive the best information on diverse manager performance because they perform on par with or better than their peers. Commissioner Roisman asked how the SEC "can help advance diversity and inclusion in the asset management industry," whether the federal securities laws "inadvertently create barriers," and what the SEC can do to overcome them. **Gilbert Garcia** of Garcia Hamilton & Associates, Chair of the Diversity & Inclusion Subcommittee, repeated his call for more diversity in the investment consultant industry. He explained that the subcommittee is considering recommending that the SEC issue an opinion stating that it is not a breach of fiduciary duty for consultants to recommend managers with fewer assets under management or shorter track records in order to facilitate the hiring of diverse managers. The subcommittee may also recommend enhancements to Form ADV to provide more transparency into the process used by consultants to recommend investment advisers. Other potential recommendations include reassessing pay-to-play rules and creating an avenue for complaints on discriminatory business practices to be filed with federal agencies.

Gilbert Garcia, Garcia Hemilton & Associates

Private Investments Subcommittee

The Private Investments Subcommittee discussed ideas for increasing retail investors' access to private investments. First, the subcommittee explored whether increasing access to private debt investments would be profitable for retail investors. It was noted that public market alternatives perform better than private credit investments over the short term, but private credit investments outperform in the long term. The subcommittee discussed principles for increasing investor access to private investments, including liquidity, diversification, and transparency regarding fees, risks, and returns. There was also a discussion of options for retail investors to access private investments, including through registered exchange-traded closed-end funds that do not have a 15 percent limit on investing in private funds, tender offer or interval funds, target-date funds that could hold more than 15 percent in illiquid assets, registered funds of private funds, and the idea of "chaperoned access," in which access to a private equity fund is provided to the retail investor by an investment professional with a duty to act in the best interest of the retail investor. The subcommittee also described its research into opportunities to provide retail investors access to real estate investments. The IAA has advocated for retail access to private investments through a registered investment adviser relationship, but the SEC has declined to expand the category of investors that can invest in the private markets to include clients of registered advisers.

2021 Agenda and Two New Subcommittees

Scot Draeger of R.M. Davis Inc. led a discussion on a new subcommittee that will address issues impacting small advisers and small funds. While this subcommittee will focus on how growing regulatory requirements increase the challenges created from resource limitations for smaller firms, the goal of the subcommittee is not to be deregulatory. Draeger listed over a dozen different workstream ideas for the subcommittee to investigate, including the evolution of FinTech as posing unique problems for smaller firms, modernizing the definition of small entities for regulatory purposes, assessing the cumulative impact of regulation on

Scot Draeger, R.M. Davis Inc.

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smaller advisers, and analyzing to what extent small advisers' issues are structural due to their size as opposed to regulatory including, for example, with respect to their access to bond issues. Draeger highlighted the results of the IAA's 2020 *Evolution Revolution* report that shows how the investment adviser industry is dominated by small firms and said that the subcommittee will look to the IAA and other industry trade associations to provide further insight into their research. The IAA frequently raises concerns with regulators about the impact of regulations on smaller advisers, and we have urged the SEC to redefine the advisers that are treated as small entities for purposes of SEC rulemaking.

Neesha Hathi of Charles Schwab Corp. discussed AMAC's other new subcommittee, which will be dedicated to the evolution of advice. This subcommittee plans to consider how "advice" should be characterized and how the level of personalization changes whether something is defined as "advice." The subcommittee intends to explore technological advancements that may unduly encourage retail investors to trade, such as through the use of digital "celebrations" and other "behavioral nudging" techniques, and the point at which this behavioral nudging crosses the personalization line. The subcommittee also will consider whether the increased access to investors' personal data that exists broadly on the Internet creates some kind of investment adviser responsibility to compare potentially inconsistent information the client provides to the adviser before making a recommendation.

The next AMAC meeting is tentatively scheduled for June. The ESG, Diversity & Inclusion, and Private Investments Subcommittees are set to conclude their work and report their recommendations by this time. Both newly created subcommittees are to continue developing their work plans and have materials ready for presentation during the next meeting.

Information relating to the AMAC meeting is available online.

Director of SEC's Chicago Regional Office Leaving SEC

Posted to IAA Today on April 27, 2021

Joel R. Levin, Director of the SEC's Chicago Regional Office, will leave the SEC at the end of May. Levin joined the SEC to serve as Director in May 2018 and before his appointment he was a federal prosecutor for over 30 years. The press release announcing his departure states that he "reinvigorated the Chicago office's outreach efforts to retail investors...to help promote financial literacy and protect against investment fraud schemes." Levin also "actively promoted and enhanced" the office's diversity and inclusion efforts.

See Joel R. Levin, Director of Chicago Regional Office, to Leave SEC (Apr. 16, 2021).

Please direct any questions or comments about these or other matters in the Legal & Regulatory Update to the IAA Legal Team at IAALegalTeam@investmentadviser.org.

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