AUTHENTICATED
U.S. GOVERNMENT
INFORMATION
GPO

OVERSIGHT OF THE SEC'S DIVISION OF INVESTMENT MANAGEMENT

HEARING

BEFORE THE

SUBCOMMITTEE ON CAPITAL MARKETS AND GOVERNMENT SPONSORED ENTERPRISES

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED FOURTEENTH CONGRESS

FIRST SESSION

OCTOBER 23, 2015

Printed for the use of the Committee on Financial Services

Serial No. 114–58

U.S. GOVERNMENT PUBLISHING OFFICE

99–777 PDF WASHINGTON : 2016

For sale by the Superintendent of Documents, U.S. Government Publishing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

HOUSE COMMITTEE ON FINANCIAL SERVICES

JEB HENSARLING, Texas, *Chairman*

PATRICK T. MCHENRY, North Carolina, *Vice Chairman*
PETER T. KING, New York
EDWARD R. ROYCE, California
FRANK D. LUCAS, Oklahoma
SCOTT GARRETT, New Jersey
RANDY NEUGEBAUER, Texas
STEVAN PEARCE, New Mexico
BILL POSEY, Florida
MICHAEL G. FITZPATRICK, Pennsylvania
LYNN A. WESTMORELAND, Georgia
BLAINE LUETKEMEYER, Missouri
BILL HUIZENGA, Michigan
SEAN P. DUFFY, Wisconsin
ROBERT HURT, Virginia
STEVE STIVERS, Ohio
STEPHEN LEE FINCHER, Tennessee
MARLIN A. STUTZMAN, Indiana
MICK MULVANEY, South Carolina
RANDY HULTGREN, Illinois
DENNIS A. ROSS, Florida
ROBERT PITTENGER, North Carolina
ANN WAGNER, Missouri
ANDY BARR, Kentucky
KEITH J. ROTHFUS, Pennsylvania
LUKE MESSER, Indiana
DAVID SCHWEIKERT, Arizona
FRANK GUINTA, New Hampshire
SCOTT TIPTON, Colorado
ROGER WILLIAMS, Texas
BRUCE POLIQUIN, Maine
MIA LOVE, Utah
FRENCH HILL, Arkansas
TOM EMMER, Minnesota

MAXINE WATERS, California, *Ranking Member*
CAROLYN B. MALONEY, New York
NYDIA M. VELÁZQUEZ, New York
BRAD SHERMAN, California
GREGORY W. MEEKS, New York
MICHAEL E. CAPUANO, Massachusetts
RUBÉN HINOJOSA, Texas
WM. LACY CLAY, Missouri
STEPHEN F. LYNCH, Massachusetts
DAVID SCOTT, Georgia
AL GREEN, Texas
EMANUEL CLEAVER, Missouri
GWEN MOORE, Wisconsin
KEITH ELLISON, Minnesota
ED PERLMUTTER, Colorado
JAMES A. HIMES, Connecticut
JOHN C. CARNEY, JR., Delaware
TERRI A. SEWELL, Alabama
BILL FOSTER, Illinois
DANIEL T. KILDEE, Michigan
PATRICK MURPHY, Florida
JOHN K. DELANEY, Maryland
KYRSTEN SINEMA, Arizona
JOYCE BEATTY, Ohio
DENNY HECK, Washington
JUAN VARGAS, California

SHANNON MCGAHN, *Staff Director*
JAMES H. CLINGER, *Chief Counsel*

SUBCOMMITTEE ON CAPITAL MARKETS AND GOVERNMENT SPONSORED ENTERPRISES

SCOTT GARRETT, New Jersey, *Chairman*

ROBERT HURT, Virginia, *Vice Chairman*
PETER T. KING, New York
EDWARD R. ROYCE, California
RANDY NEUGEBAUER, Texas
PATRICK T. MCHENRY, North Carolina
BILL HUIZENGA, Michigan
SEAN P. DUFFY, Wisconsin
STEVE STIVERS, Ohio
STEPHEN LEE FINCHER, Tennessee
RANDY HULTGREN, Illinois
DENNIS A. ROSS, Florida
ANN WAGNER, Missouri
LUKE MESSER, Indiana
DAVID SCHWEIKERT, Arizona
BRUCE POLIQUIN, Maine
FRENCH HILL, Arkansas

CAROLYN B. MALONEY, New York, *Ranking Member*
BRAD SHERMAN, California
RUBÉN HINOJOSA, Texas
STEPHEN F. LYNCH, Massachusetts
ED PERLMUTTER, Colorado
DAVID SCOTT, Georgia
JAMES A. HIMES, Connecticut
KEITH ELLISON, Minnesota
BILL FOSTER, Illinois
GREGORY W. MEEKS, New York
JOHN C. CARNEY, JR., Delaware
TERRI A. SEWELL, Alabama
PATRICK MURPHY, Florida

CONTENTS

	Page
Hearing held on:	
October 23, 2015	1
Appendix:	
October 23, 2015	39

WITNESSES

FRIDAY, OCTOBER 23, 2015

Grim, David W., Director, Division of Investment Management, U.S. Securities and Exchange Commission	4

APPENDIX

Prepared statements:	
Grim, David W.	40

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

Grim, David W.:	
Written responses to questions for the record submitted by Representatives Poliquin and Hultgren	48

OVERSIGHT OF THE SEC'S DIVISION OF INVESTMENT MANAGEMENT

Friday, October 23, 2015

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON CAPITAL MARKETS AND
GOVERNMENT SPONSORED ENTERPRISES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:15 a.m., in room 2128, Rayburn House Office Building, Hon. Scott Garrett [chairman of the subcommittee] presiding.

Members present: Representatives Garrett, Hurt, Royce, Neugebauer, Huizenga, Duffy, Stivers, Hultgren, Ross, Messer, Schweikert, Poliquin, Hill; Maloney, Sherman, Lynch, Perlmutter, Scott, Himes, Foster, Carney, Sewell, and Murphy.

Also present: Representative Velazquez.

Chairman GARRETT. Good morning, everyone. The Subcommittee on Capital Markets and Government Sponsored Enterprises will now come to order. Without objection, the Chair is authorized to declare a recess of the subcommittee at any time.

Today's hearing is entitled, "Oversight of the SEC's Division of Investment Management." I welcome our witness, the Director of the Division, Mr. David Grim.

Without objection, members of the Full Financial Services Committee who are not members of the subcommittee will be recognized for the purpose of questioning the witness.

I will now recognize myself for 3 minutes for an opening statement.

Today's hearing will focus on the oversight of the SEC's Division of Investment Management. This will actually be the fourth oversight hearing that this subcommittee has held in just this last year-and-a-half with regard to various divisions within the SEC.

Mr. Grim, thank you for joining us today for this hearing. And also congratulations to you, and some would also say condolences to you as well, on your recent appointment to head up the Division. Thank you also, of course, for your hard work at the Commission for 2 decades, 20 years.

The Division of Investment Management has broad regulatory responsibility over registered investment companies, ICIs, investment advisers, asset managers, and other entities that manage money basically on behalf of investors. And this year actually marks the 75th anniversary of the Investment Company Act and the Investment Advisers Act as well, two statutes that the SEC has

administered for years as an independent—I note that—agency with expertise over our capital markets.

Though many on this committee, myself included, often disagree with some of the actions of the SEC, I believe that there is broad bipartisan agreement that the Commission should remain the primary regulator of investment funds and our capital markets, and that the Commission's independence should never be compromised. However, recently the SEC's independence has come under increasing threat from unaccountable and secretive regulatory bodies—namely, the FSOC, the Federal Reserve, and the Financial Stability Board—that appear to be on a mission to eliminate risk from our capital markets by imposing bank-like regulations on asset managers and others that have been deemed part of the so-called shadow banking system.

The FSOC, in particular, has not been shy in the past about using its bully pulpit, if you will, to influence or to threaten or cajole other regulators into carrying out its agenda, this despite the fact that expertise over the asset management industry and registered investment companies resides not with the prudential regulators, but with the SEC, and specifically with the Division of Investment Management.

And so to that end, I am encouraged that the SEC is finally beginning to assert its jurisdiction in this area. Last year, Chair White laid out a rulemaking agenda for asset managers that so far includes proposals for enhanced disclosure, as well as rules for liquidity management by investment funds. Now, I would prefer that the SEC draft such new rules as opposed to the FSOC or the Federal Reserve. I do remain concerned that part of the SEC's agenda is still subject to an inappropriate influence by the prudential regulators.

And so, today, as part of our oversight responsibility, this subcommittee will be closely monitoring the SEC's actions in this area to ensure that they actually reflect the SEC's threefold mission and are not simply an ad hoc response to threats from other regulatory bodies.

Additionally, I am eager to hear today about the Division's work regarding Section 913 of the Dodd-Frank Act, and the Department of Labor's Fiduciary Rule, as well as the efforts that the Division is undertaking to just generally to promote capital formation.

And so with that, Director Grim, thank you again for being with us here. And I now yield 5 minutes to the ranking member of the subcommittee, Mrs. Maloney.

Mrs. MALONEY. Thank you so much, Mr. Chairman, for this continuing oversight hearing that you have arranged. And I welcome Mr. Grim to our hearing today.

The SEC's Division of Investment Management is one of the agency's most important divisions because it regulates the asset management industry including investment advisers, mutual funds, and exchange traded funds (ETFs).

Mutual funds and ETFs have been growing at an incredibly rapid pace in recent years. Mutual funds have grown from $4.4 trillion in assets in 2000 to a whopping $12.7 trillion in assets presently. And ETFs have grown from $151 billion in assets in 2003 to nearly $2 trillion today.

There are nearly 12,000 registered investment advisers overseen by the Investment Management Division, and these investment advisers report over $62 trillion in assets under management. So it is fair to say that the Investment Management Division has its work cut out for it. When an industry is growing and innovating as rapidly as the asset management industry, it is critical that the regulator not get left behind.

So has the growth come from new products that pose excessive risks or that investors don't fully understand? Has the industry's core infrastructure kept pace with the rapid growth?

On this score, the Investment Management Division is beginning to catch up with the industry. For instance, the Division is working on three critical new rules on liquidity management for mutual funds, which is an area that some regulators have argued poses a risk to the markets. The Financial Stability Oversight Council, or FSOC, has expressed concern that without proper liquidity management there is a risk that funds could be forced into a fire sale of illiquid assets which would send prices plummeting and harm the broader markets.

It is not entirely clear how big this risk is. But after the financial crisis of 2008, prudence is the best course. So the SEC has responded by embarking on a series of rulemakings, led by the Investment Management Division, that are designed to protect investors by requiring mutual funds to bolster their liquidity management practices. And I think the SEC should be praised for these rulemakings. Thank you.

In May, the SEC proposed to enhance disclosures about mutual funds' liquidity which will allow investors to make more informed choices and potentially avoid investing in funds that are riskier than an investor wants. And just last month, the SEC proposed a new rule that would allow mutual funds to use something called swing pricing, which would force investors who are withdrawing their money from mutual funds to internalize the cost of their withdrawals and thus protect the remaining investors.

I think that this is a sensible proposal to the extent that the liquidity issues in mutual funds could create a real first-mover advantage, in other words, an incentive for investors to withdraw their money first, like on a bank run. Swing pricing has the potential to eliminate that first-mover advantage entirely.

This latest proposed rule also formalizes and enhances the SEC's longstanding liquidity guidelines for mutual funds, which will provide more consistent and robust liquidity practices across the entire mutual fund industry.

So I am encouraged by the Investment Management Division's work in this area, and I hope that they will continue to press ahead with the proposals that Chair Mary Jo White outlined before this committee earlier. I look forward to hearing more from Mr. Grim about his work on these proposals. And I yield back.

Thank you very much for coming.

Chairman GARRETT. The gentlelady yields back.

I now turn to the vice chairman of the subcommittee, the gentleman from Virginia, Mr. Hurt, for 2 minutes.

Mr. HURT. Thank you, Mr. Chairman. I thank you for holding today's hearing.

Welcome, Mr. Grim. Thank you for joining us today.

I am pleased that this subcommittee is continuing to focus on vigorous oversight and accountability within the SEC. Today's hearing is an important reminder of the critical functions that the SEC's Division of Investment Management plays in our economy as the SEC's mission includes the critical component of facilitating capital formation.

Capital formation is crucial to the success of our economy, and as I travel across Virginia's Fifth congressional district, my district, I am regularly reminded of how our Nation's small businesses and startups depend on access to private capital to be successful.

I am also regularly reminded that well-intended Federal regulation often results in creating unnecessary costs and barriers to capital formation. As you may know, I have been a proponent of legislative initiatives that would encourage economic growth and job creation by increasing the flow of private capital to small businesses that are found on Main Streets all across America. Unfortunately, the Dodd-Frank Act, in many instances, has placed a costly and unnecessary regulatory burden of SEC registration, specifically SEC registration on advisers to private equity funds, while exempting advisers to other similar funds.

A bill that Representative Jim Himes and I sponsored last Congress passed the House on a bipartisan basis and, if enacted, would have eliminated this unnecessary burden and would have put private equity funds on a similar playing field as that of other similar advisers.

The reality is simple: private equity funds and their advisers did not cause the financial crisis, and I believe there is general consensus that they are not a source of systemic risk. In my district, there are literally thousands of jobs that exist because of the investment by private equity funds. I believe that the treatment in Dodd-Frank of advisers to private equity funds suggests that this committee review the overall Investment Advisers Act registration regime and look for ways to make sure that the laws in this area are, in fact, protecting investors and are, in fact, facilitating capital formation at a time when capital formation is desperately needed in places like my congressional district.

I look forward to your testimony, Mr. Grim, and I thank you for your appearance.

Mr. Chairman, I thank you. And I yield back the balance of my time.

Chairman GARRETT. Thank you. The gentleman yields back. And now, we turn to our witness. Mr. David Grim is the Director of the Division of Investment Management at the SEC.

Again, thank you for being with us today. You will be recognized for 5 minutes. And you know, the protocol here: without objection, your entire written statement will be made a part of the record. Again, thank you. You are now recognized.

STATEMENT OF DAVID W. GRIM, DIRECTOR, DIVISION OF INVESTMENT MANAGEMENT, U.S. SECURITIES AND EXCHANGE COMMISSION

Mr. GRIM. Good morning, Chairman Garrett, Ranking Member Maloney, and members of the subcommittee. Thank you for invit-

ing me to testify about the U.S. Securities and Exchange Commission, and about the Division of Investment Management's activities and responsibilities.

The mission of the Commission is to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation. The Division promotes this mission through regulating the asset management industry.

A primary function of the Division is to administer the Investment Company Act of 1940 and the Investment Advisers Act of 1940, and to develop regulatory policy for both investment companies and investment advisers, which play a major role in the lives of Americans and our national economy.

The four core activities of the Division are: one, crafting rulemaking recommendations to the Commission; two, revealing fund filings; three, providing interpretive and other advice to the asset management industry and the public; and four, monitoring risks in the assessment management industry.

With respect to rulemaking, in 2014 the Commission adopted significant reforms to the rules governing money market mutual funds. The amendments are intended to reduce the risk of runs on money market funds, provide important tools to help further protect investors and the financial system in a crisis, and enhance the transparency and fairness of these products for America's investors.

In September 2015, the Commission also adopted amendments related to the removal of credit ratings references in the primary rule that governs money market funds and in the money market fund portfolio disclosure form.

These amendments give effect to Section 939A of the Dodd-Frank Act.

In May 2015, the Commission proposed new rules and forms, as well as amendments to its rules and forms, to modernize the reporting and disclosure of information by registered investment companies. The proposed rules, if adopted, would require registered funds to provide portfolio-wide and position-level holdings data to the Commission on a monthly basis, and annually report certain streamlined and updated census-type information. If adopted, funds would report portfolio and census information in a structured data format.

Also in May 2015, the Commission proposed amendments to obtain additional information regarding advisers, including information about their separately managed account business. On September 22, 2015, the Commission proposed a new rule that would require open-end funds to adopt and implement liquidity management programs. The proposed amendments also would permit mutual funds to use swing pricing and would enhance disclosure regarding fund liquidity and redemption practices.

At the direction of the Chair, the Division also is working on other asset management-related potential new rules concerning use of derivatives by investment companies, transition plans for investment advisers, stress testing for large advisers and large investment companies, third-party compliance reviews for investment advisers, and a uniform fiduciary standard of conduct for broker-dealers and investment advisers when providing personalized investment advice about securities to retail customers.

In addition to rulemaking, Division staff responsibilities include: reviewing and commenting on the numerous prospectuses, proxy statements, and other disclosure documents filed by funds each year; continuing to fulfill the Sarbanes-Oxley Act requirement to review investment company issuer accounting statements at least once every 3 years; issuing no-action letters, interpretive letters, and other guidance under both the Investment Company Act and the Investment Advisers Act; reviewing enforcement matters that concern investment companies and investment advisers; and reviewing applications from entities that request exemptions from provisions of the Investment Company Act and the Investment Advisers Act.

Finally, pursuant to Section 965 of the Dodd-Frank Act, the Division also established a new Risk and Examinations Office. Division staff assigned to this office monitor trends in the asset management industry and carry out the Division's limited inspection and examination program.

In conclusion, thank you again for inviting me to discuss the Division's activities and responsibilities. I am happy to answer your questions.

[The prepared statement of Director Grim can be found on page 40 of the appendix.]

Chairman GARRETT. Thank you. And, again, I appreciate you being here.

So the SEC, in short, would you call it a prudential regulator? Is that its mission?

Mr. GRIM. The SEC has a three-part mission: protect investors; facilitate capital formation; and maintain fair and orderly markets. It is not a prudential regulator.

Chairman GARRETT. Okay. So back in January, Fed Governor Dan Tarullo said in a speech, "Both the short-term wholesale funding and asset management examples point to the broader objective of developing what we might call or term prudential market regulation." You know Governor Tarullo, and he is one of the more outspoken governors out there.

Have you ever heard—you have been there for 20 years at the SEC or just shy of 20 years—the term "prudential market regulation" before?

Mr. GRIM. No.

Chairman GARRETT. No. So my next question was going to be, can you explain to me what prudential market regulation is? I guess that is a hard question to answer.

Mr. GRIM. I think that I would say that there has been—as you know, FSOC has been looking at the asset management industry for potential systemic risks in the asset management industry. As part of that look, there has been a focus on how to best approach any potential systemic risk.

Chairman GARRETT. Systemic risk. Let's bring it to a close on this last point. So the rules that have come out from the SEC, would you call them prudential market regulation?

Mr. GRIM. I would call them rules that we think advance the SEC's three-part mission.

Chairman GARRETT. Three-part mission, okay.

When we invited you to come here, we sent you a whole list of questions or things we wanted to talk about. One of those things is your dealings with the FSOC. And I guess to that point, we asked exactly what is your involvement with the divisions and so on and so forth. And I think you only really gave one—well, maybe it was two sentences back on December 18th, basically saying that you met with them, Division staff has reviewed comments received on its notice, so on and so forth, dealing with their public comments of potential risk to financial stability. You really didn't flesh that out too much in your written statement.

So can you provide us briefly with a little more detail on how the Division is working with the FSOC on the review of asset management products and activities? And specifically, who are you meeting with over there, are they just from the Treasury, is there just one group or other groups, who are you meeting with over there, answer that as well?

Mr. GRIM. With respect to FSOC, I think the first point I would make is that at the SEC, it is the Chair who is the member of FSOC. So in terms of me and my Division's role, when there are asset management issues on the table, we are assisting her in providing our subject matter expertise.

Chairman GARRETT. So is your staff—I am not talking about her now—specifically meeting with them at that point?

Mr. GRIM. As part of the SEC's engagement with FSOC, yes, our staff meets with the staff of—

Chairman GARRETT. Okay. And when you are doing that, whom are you meeting with? Are you meeting just with folks from over in Treasury? Or are you meeting with all of the various agencies that are under—

Mr. GRIM. All of the various agencies and their members.

Chairman GARRETT. Okay. And lastly on this, I am trying to get a picture of how this actually works, is this on a regular basis? Is this weekly, monthly? How does that all play out?

Mr. GRIM. It is sort of as needed. I don't know that there is a regularity to it. But I would say it is as needed on the—

Chairman GARRETT. I said that was my last question, but I have one more question. Are they soliciting input from you on these things or is it a two-way street? How does that work?

Mr. GRIM. We are offering our subject matter expertise on any of these issues that are asset management.

Chairman GARRETT. But are they asking you? Because when I talk to some of these folks over there, some of them readily admit that this is not their forte, this is not their area of expertise. When we delve into it, that becomes very evident. And so we are trying to figure out where they are getting their information from. If it is not from you, then where is it coming from?

Mr. GRIM. Yes, I would say they have solicited our views on these matters.

Chairman GARRETT. Okay. I will just go a little bit over my time.

Proxy advisers, very quickly, earlier on, the Division issued a Staff Legal Bulletin 20 regarding proxy advisers voting responsibilities which clarified that investment managers are not obligated to vote for every proxy issue for the shares that they manage and they have an ongoing fiduciary responsibility. We have gone

through one proxy season. Can you briefly tell us, have you looked at the results on that? And how is that all playing out now?

Mr. GRIM. You are absolutely right. As you know, we had a Commission roundtable on proxy advisory firms that addressed a number of issues. One of the issues was investment adviser use of proxy adviser firms. Part of the response to that was the staff legal bulletin that you referenced.

Chairman GARRETT. Right. Is it having the intended effect or not really?

Mr. GRIM. We are still studying that. The first proxy season just ended. My colleagues in the examination unit are doing some exams around how it is going. But anecdotally, we think it has been having a positive effect.

Chairman GARRETT. Okay. My time is way over. I will yield to the ranking member with some leniency there.

Mrs. MALONEY. Thank you so much.

Mr. Grim, I would like to ask you about the assessment management rulemakings. As you know, last December Chair White appeared before this committee and she outlined a three-part pan to update the regulatory regime for assessment managers due to the significant changes in the industry in recent years. And the SEC has now proposed two of the three rules that she promised: enhanced disclosures; and liquidity management rules. But we still haven't seen the third rule yet, which will require transition plans for winding down asset managers.

Can you give us an update on this third rule? When do you expect the staff to be ready to present the Commission with a set of recommendations for this rule?

Mr. GRIM. On stress testing and transition plans, I think one of the things the crisis showed us was the importance of planning for stress, the importance of planning for transitions. And as a result, as you point out, that is an important initiative on our list of priorities.

With respect to stress testing, it is actually a Dodd-Frank-mandated requirement that we develop stress testing rules for large nonbank entities, some of which are the registrants in our world.

And we have made terrific progress on both. With respect to stress testing, as a matter of fact, we have stress testing rules already in existence on money market funds. They were part of the money market fund rules that I mentioned in my opening statement. These rules are now looking to develop the right kind of stress testing approach for other kinds of large investment companies. We are making great progress on our recommendation to the Commission. In terms of timing, obviously that is up to the Commission when they are ready to vote on it.

Mrs. MALONEY. Do you have a general sense? In a year? Six months? Whatever. A general—

Mr. GRIM. It is hard to know. All I can say is that we have made great progress on the recommendations and I am hoping it is going to be in the near term.

Mrs. MALONEY. Okay. I mentioned in my opening remarks the SEC's proposal on swing pricing in my statement, but I want to drill down on that a little bit. I understand that other countries, particularly in Europe, already use the swing pricing, but I under-

stand that there might be some operational challenges to adopting it in the United States. Can you tell us what the SEC found as you were developing this proposal, and why did the SEC make swing pricing voluntary in its proposed rule? Why not make it mandatory as they do in Europe?

Mr. GRIM. With respect to swing pricing, the Commission unanimously proposed it as part of our liquidity rule. And I think what we were trying to accomplish with it is, it is really an intent to make fund pricing more fair for all investors. So it is the investors getting out, out of the fund through redemptions, they are paying the cost that their activity generates for the funds. That makes it fair for those investors. It also makes it fair for the remaining investors in the fund. It allocates the cost more fairly. That is what we were trying to accomplish.

You are correct to point out that there are potentially some operational challenges with the swing pricing. We spent a lot of time in our release asking questions about those. It is out for public comment right now and we are very much looking forward to getting the public reaction to those questions, as well as others around swing pricing.

Mrs. MALONEY. Are there situations where swing pricing could harm certain investors?

Mr. GRIM. We hope not. That is obviously not what we want, investor protection being part of our mandate, and we hope not. But that is part of the public comment process. We will hear from all sides of the issue and develop our recommendation for the Commission in light of the public comment.

Mrs. MALONEY. If swing pricing had been in effect, would it have changed in any way the economic crisis and the response that took place in 2008 where there was a run on the mutual funds and a run on a lot of equity products?

Mr. GRIM. The focus of the most harmful runs during the crisis was in the money market fund space in particular. The money market fund rules have already been adopted by the Commission in response to that. It is hard to say whether taking it to the sort of other kinds of funds that are under our—how it would have changed behavior or the results of the crisis. But I think I would say, again, what we are trying to promote is a fair thing that is better for all investors within the fund. So we will see what the public thinks of our proposal.

Mrs. MALONEY. My time has expired. Thank you.

Chairman GARRETT. Thank you. The gentlelady yields back.

The gentleman from Virginia is now recognized.

Mr. HURT. Thank you, Mr. Chairman.

Mr. Grim, we know that two of the three components of the SEC's mission, obviously, are to protect investors and to facilitate capital formation. So I had a couple of questions as it relates to private equity funds and the registration requirements for their advisers.

Do you think it is fair to say that private equity funds did not contribute to or cause the crisis of 2008? Do you think that is a fair statement?

Mr. GRIM. Sure.

Mr. HURT. Do you agree that there is a general consensus that those funds do not present systemic risk? Is that a fair statement?

Mr. GRIM. I think with respect to the SEC's focus on private equity funds, in the Dodd-Frank Act, Congress determined to have private equity fund managers register with the Commission. My Division sort of did the rules implementing that registration. And I think that we think that is a good thing. We think it is good that they are registered with us. The protections that come from being registered with us are important.

Mr. HURT. But would you agree that they don't present systemic risk? There is no evidence that the private equity funds present systemic risk.

Mr. GRIM. I guess the ultimate people to determine that would be the FSOC. As I mentioned before, I am not the FSOC. So they would determine whether they are. I think, with respect, our focus has been on investor protection.

Mr. HURT. But there is generally a different model that they follow that would not lead to cascading losses. And we are talking about pretty sophisticated investors. So you can't say whether you think that they present systemic risk or not in your opinion as a regulator?

Mr. GRIM. Again, I think our focus has been on the investor, potential investor protection issues that private equity funds raise. Our exam staff has done a number of exams recently. And while, of course, they see a range of practice, they have found some things in the fee area that have raised some investor protection concerns, and we have been particularly focused on those issues.

Mr. HURT. And understanding full well that the regulations that you enforce have in many instances come from Dodd-Frank, this particular provision did, with that said, do you, in your role, do you feel like you have an ability to tailor the enforcement and rulemaking to reflect the fact that these funds are different than others?

Mr. GRIM. Yes, we do, and in fact we have.

Mr. HURT. Can you give us some examples of that?

Mr. GRIM. Sure. One of the questions that the private equity industry had after these registration rules were adopted was about certain instruments that they invest in that raise—there are questions raised about how to custody those instruments. And our staff was able to provide some technical advice to them. It is sort of on how the custody rule works. And I think it is a good example of where us taking a fresh look at our rules, how they apply to a new set of—

Mr. HURT. Do you see opportunities to continue to do that in the future?

Mr. GRIM. Sure.

Mr. HURT. Chair White recently gave a speech in which she talked about the tremendous amount of information that you all are now receiving because of this. How is that information helpful?

Mr. GRIM. What it allows us to do, in addition to having the examination authority that I mentioned before, where we can go into a specific firm and look specifically at them, the other kind of information that we now get under the rules that we adopted pursuant to Dodd-Frank is broad, industry-wide, so we can look at trends,

we can look at risks to the extent that they exist, and we can be better informed regulators as we—

Mr. HURT. Have they actually been useful? You say you can look broadly across the spectrum and look at risk. Are there examples of where that has been useful up to this point?

Mr. GRIM. Absolutely. As a matter of fact, just the other day—Form PF is the form that a lot of these funds file extensive information with us on, and we published for the first time some sort of global industry data about the private fund industry. And we think it has been good for us. We think it is good for the public. And so we are very happy with it.

Mr. HURT. I think my time has expired. Thank you, sir.

Chairman GARRETT. The gentleman yields back.

I now recognize the gentleman from Massachusetts, Mr. Lynch.

Mr. LYNCH. Thank you, Mr. Chairman.

And thank you, Mr. Grim, for your willingness to help the committee with its work.

Sometimes, this committee can be like a conveyor belt where we have a new issue every 7 seconds and we are on to the next rule or the next topic. I see in your remarks, your extended written remarks, you talk about the money market funds rule that we adopted back in July of 2014, where we allowed the NAV to float. There was a lot of debate here of what the impact of that might be.

Now, I realize with that type of rule, it is sort of like you are trying to test the seaworthiness of a ship and it is not necessarily easy to do when things are calm. But do you have any data for us or any experience, complaints, progress reports, lack of progress reports from the adoption of that rule on how that might be going?

Mr. GRIM. You correctly point out that one of the parts of the money market fund rule that the Commission adopted last year was the floating NAV provision which applies to a particular type of money market fund, institutional prime funds. And those rules were adopted by the Commission after—

Mr. LYNCH. Right. There were a lot of concerns raised from—I have some big asset managers in my district, Fidelity among them. They do a great job. But there were some concerns raised by them. And I am just interested in hearing how things are going.

Mr. GRIM. Subsequent to passing the rule, the Commission staff has put together a team, a sort of money market fund implementation team to monitor for just these kind of things that you are asking about. A number of fund complexes have announced changes to their lineups in response to the rules. Some will do the floating NAV funds. Some are not going to do the floating NAV funds.

So there is a lot of work going on implementation-wise within the industry. I think that the compliance date isn't until October of 2016. So we are still a little way from knowing exactly how it is all going to shake out. But we are monitoring it. A lot of work being done to implement the rule.

Mr. LYNCH. So is it too early to tell? Is that what you are saying?

Mr. GRIM. I think that is fair to say.

Mr. LYNCH. Okay. That is a fair answer.

I wanted to ask you about the explosion in the number of funds that are out there. It has gone from I think $94 billion in 1979 to something like $17 trillion now. These mutual funds and ETFs are

a wonderful way for working people to prepare for their retirement and they can be a real blessing if they are run properly.

While the number of funds and the amount of assets has exploded, the number of inspectors and folks on your side who monitor these funds has actually shrunk. I think it is down to one inspector for every, I don't know, $5 trillion dollars or something like that. It is a ridiculous number. And I am just wondering about your ability at the SEC, within your department, within your Division, to do the job that you are required to do. Can you talk about that a little bit?

Mr. GRIM. On the investment adviser exam question, the first thing I would say is that just about all of the examiners at the SEC who examine investment advisers are actually in our examination unit, which is not part of Investment Management. Investment Management does have a small exam unit which is set up a little bit differently which I can talk about in a minute.

But I think—look, as the Chair has been very clear about, our ability to examine advisers in a frequent enough way is a huge—

Mr. LYNCH. Right now, if I am not mistaken, it is once every 10 years. That is because you only have so many people to conduct the exams. Is that right?

Mr. GRIM. It is 10 percent of advisers per year. There are different ways to measure it of course. One, it is about a third of the assets in the industry that we get to every year. But regardless of what the numbers are, the bottom line is that it is a challenge for us. This is an issue that has been on our minds for a long time.

Mr. LYNCH. So we need more people. Is that right?

Mr. GRIM. That is part of what the Chair asked for in her most recent budget request. But there are other things that we are considering. After Dodd-Frank, there was a study that was required of the investment adviser exam issue, the SEC staff study, it was reported to Congress, and it had three potential options: user fees paid for by investment advisers; an SRO for investment advisers; and FINRA having sort of exam authority over dual registrants, broker-dealer investment advisers.

That study was turned in. The conversation has continued. Chair White more recently has talked about the concept of third-party compliance exams as another potential way to create more touches on investment advisers. She has asked—

Mr. LYNCH. My time has expired. I thank the gentleman. I yield back.

Chairman GARRETT. I recognize the gentleman from Texas, Mr. Neugebauer.

Mr. NEUGEBAUER. Thank you, Mr. Chairman.

Mr. Grim, thank you for being here this morning. Labor Secretary Perez testified that the Department of Labor has coordinated with the SEC in the development of their proposed fiduciary standard. What coordination have you had with the Department of Labor?

Mr. GRIM. SEC staff in my Division and in other places in the building have provided our technical expertise to our colleagues at the Labor Department about the potential impact of certain choices that they are making or may make in their rule proposal.

Mr. NEUGEBAUER. That leads me to my next question, then. What kind of analysis has your Division done of the impact it would have on investment advisers who have registered with the SEC?

Mr. GRIM. Chair White has directed the staff, including my staff, to develop a recommendation at the SEC for the SEC's version of the uniform fiduciary duty that would apply to investment advisers and broker-dealers. As part of developing that recommendation, our staff has done extensive analysis around a number of impact questions. Going all the way back to following Dodd-Frank, the SEC staff did a study about the possibility of recommending a uniform fiduciary duty for investment advisers and broker-dealers. We got lots of comments on that study that we considered.

Subsequent to that, we did a request for information, for further information, and got lots of comments on that. So I think it is fair to say that SEC staff has been studying this issue extensively.

Mr. NEUGEBAUER. So you have done an analysis?

Mr. GRIM. We are doing it right now. The Chair has asked us for a recommendation as part of our recommendation to her. But this is on the SEC. So I think maybe your question was about DOL.

Mr. NEUGEBAUER. I want to make sure I understand. So you are doing the analysis and getting ready to make the recommendation? Or you have done the analysis and you are now prepared to do the recommendation?

Mr. GRIM. We are doing the analysis as part of developing a recommendation for the Commission.

Mr. NEUGEBAUER. I personally, and maybe other members of the committee, would like to see that analysis when it is complete because I think the impact it is going to have is going to be an important part of that. Obviously, we are going to want to see your recommendation as well, because this is an issue that has a huge impact, obviously, on investors and the industry as a whole.

Are you concerned that the investment advisers are subject to two different fiduciary standards based on the products that they recommend, retirement or not? Is that confusing? And is that productive?

Mr. GRIM. The way the law works right now—obviously, I am not an expert on the Employee Retirement Security Act(ERISA)—as I understand it, is that certain investment advisers who have ERISA clients are subject to ERISA standards and SEC standards for those clients and they are subject to SEC standards for other types of clients.

With respect to, obviously, DOL, as you have referenced, has a proposal out that would add—not add—DOL's—this is where I am getting a little bit out of my area of expertise obviously—DOL's thing has a proposal around how its standard would work for broker, for example, for broker IRA advice and they are developing that.

As I mentioned at the beginning, we are providing our technical expertise about impacts of those choices. But, ultimately, it is up to DOL. That is a DOL mandate, a DOL statute, ERISA is a separate statute, and it is going to be up to them what they decide to do.

Mr. NEUGEBAUER. Mr. Chairman, I yield back.

Chairman GARRETT. Thank you. The gentleman yields back.

Moving down the row, I recognize the gentleman from Colorado, Mr. Perlmutter.

Mr. PERLMUTTER. Thanks, Mr. Chairman. I have a couple of questions on business development companies. And then whatever time I have left, I am going to yield to Ms. Velazquez for whatever questions she has.

Mr. Grim, thank you for your testimony today. Are you familiar with business development companies under the Investment Company Act?

Mr. GRIM. Yes.

Mr. PERLMUTTER. What are they quickly, just for the record?

Mr. GRIM. Business development companies are a specific type of investment company that Congress, back in 1980, set up a similar but a little bit different regime for, as compared to other funds under the Investment Company Act, in recognition of their focus on investing in small and emerging businesses.

Mr. PERLMUTTER. Is it one of the areas that you oversee or your Division does?

Mr. GRIM. Yes.

Mr. PERLMUTTER. Okay. So my question is, there has been a proposal or at least some conversation here in Congress to take a look at the eligible acquisitions of business development companies. Seventy percent are supposed to be in small public companies or the like. Thirty percent can be—there is more discretion with 30 percent. And then also the leverage that business development companies have, right now it is 1 to 1, equity to lending. The request would be to go to 2 to 1 so that you could have a little more leverage.

Are you familiar with that proposal that has been floated?

Mr. GRIM. Yes, I am generally aware of some of the legislative efforts in this regard.

Mr. PERLMUTTER. Have you thought about it? What is your reaction to it?

Mr. GRIM. I would say a couple of things in response to that. First of all, one of the reasons that we are very focused on BDCs is because they are predominantly held by retail investors. And a second point I would make is that they have grown quite a bit, from $5 billion to $50 billion in net assets just from 2004 until today.

So looking at it through that lens, there have been bills that have been discussed here on the Hill. There was actually one a couple of years ago where Chair White wrote a letter on behalf of it. And I think in terms of how she and we approach these things, when it comes to BDCs you have issuers that sort of touch on two key parts of our mission: the capital formation part of our mission; and the investor protection part of our mission. And I think what she said in her letter was, while BDCs have the ability to take on more leverage already than other types of funds based on the way Congress has drawn the lines previously, this bill would add to that leverage and that could potentially raise investor protection concerns. So that was the gist of the letter that she wrote previously on the bill.

Mr. PERLMUTTER. Okay. Thank you.

I have 1½ minutes. Ms. Velazquez, would you like my 1½ minutes? Okay. I will yield back to the Chair.

Chairman GARRETT. The gentleman yields back.

Mr. Duffy is now recognized for questions.

Mr. DUFFY. Thank you, Mr. Chairman.

Mr. Grim, thank you for coming in today. I believe this is your first time before the committee. You are doing a great job. Thank you.

Obviously, you have been at the SEC for over 2 decades, so you are very smart, and very well-informed. You were in the bunker during the 2008 financial crisis. And since then, you have been able to see a concerted focus on systemic risk in the financial sector. Both the FSOC and the FSB have been focused in recent years on the asset management industry.

While the SEC is the expert regulator in this segment, the FSOC seems to have a heightened interest in the risk that asset managers pose to the broader global economy. It has been speculated by some that FSOC has a designation of an asset manager as a SIFI at some point in the future.

Now, we know that banks and asset managers operate under distinctly different business models. Do you feel like FSOC members sufficiently understand the asset management industry if they are going to be designating them potentially as a SIFI?

Mr. GRIM. With respect to FSOC, I think that it is important that as Congress set up FSOC, it has all of the financial regulators together. And the SEC, with Chair White being the member, it is critical for her to be there offering her subject matter expertise on all issues under sort of SEC market issues, but including the asset management issue that, obviously, I am most familiar with.

Mr. DUFFY. I know you are very familiar with it. But it goes back to my question, do you think the FSOC members sufficiently understand the asset management industry? It is kind of a yes-or-no question. You are doing a good job of not really answering the question. Kudos. Do you think they are well-suited?

Mr. GRIM. It is hard for me to comment on their level of understanding. But I think the main thing I would emphasize is we are—Chair White is at the table. The SEC is involved in these conversations about asset management sharing.

Mr. DUFFY. Do you think they have your kind of knowledge or the Division's knowledge? Are they as well-versed on these issues as you are and your team is?

Mr. GRIM. Well, no.

Mr. DUFFY. I would agree with that. Good answer.

Now, you had indicated, I think to Mr. Garrett, that you offer your subject matter expertise to FSOC. Do they actually take your advice?

Mr. GRIM. When it comes to the asset management issues, we have been at the table. We have been offering our expertise.

Mr. DUFFY. Do they take the advice?

Mr. GRIM. I think it is fair to say that they—

Mr. DUFFY. Kind of yes, kind of no?

Mr. GRIM. Look, sometimes we agree, and sometimes we don't agree.

Mr. DUFFY. Okay. Fair enough.

Mr. Hurt asked you this question, and I want to come back to it. In all of your expertise, and you agreed and I would agree with you that you are kind of the guy in this space, do you believe that the asset management industry poses a systemic risk to the financial sector?

Mr. GRIM. That is ultimately a determination that is up to FSOC.

Mr. DUFFY. Do you think that is a good idea? As an SEC guy, being there for over 20 years, who knows this sector better than anybody else, is it the SEC's position that you should cede this territory to FSOC and they are the ones best positioned to make this determination because you and the Division don't know? Do you think that is the best—is that your position at FSOC? Is that Mary Jo White's position?

Mr. GRIM. Obviously, you would have to ask Mary Jo what her position is. I think that what I would say is, look, the crisis, in my view, showed the importance of the financial regulators having a mechanism to sit and share views and that is what Dodd-Frank set up for the—

Mr. DUFFY. I know.

Mr. GRIM. But obviously, as part of that, we view ourselves as the technical experts on market issues generally and on asset management issues.

Mr. DUFFY. And I hope that the SEC would be a little concerned about mission creep and allowing decisions to be made with the technical experts, which is with you, as opposed to folks who do a lot of different things within FSOC but don't have your technical knowledge.

I would ask you, do you think there was some concern when the OFR came out with their report on asset management, how bad it was and how many people disagreed with the assessment? Does that give you some pause with regard to FSOC's capabilities?

Mr. GRIM. I think that the recent approach by FSOC where they have sort of shifted to a focus on activities and issued a request for comment on that focus, I think we view that as a shift consistent with how—

Mr. DUFFY. Okay. Can I ask one more question, with a quick answer, yes or no? Do you think that Governor Tarullo fully understands the intricacies of the assessment management industry and is working to achieve the best outcome for U.S. companies? Yes or no or maybe?

Mr. GRIM. I think I would say that the SEC with Governor Tarullo and the other—any of the FSOC members, so to speak, we are sharing our views with him, sharing our subject matter expertise with him.

Mr. DUFFY. I will take that as a no.

I yield back.

Chairman GARRETT. The gentleman is recognized with a little bit of wiggle room on the end of it.

Mr. SCOTT. Thank you, sir.

Mr. Grim, you are the Director of the Division of Investment Management for the U.S. Securities and Exchange Commission, correct?

Mr. GRIM. Yes.

Mr. SCOTT. And are you aware on the fiduciary issue, that we wrote into Dodd-Frank that it was the domain of the Securities and Exchange Commission to come up with a uniform definition, if need be, of "fiduciary?"

Mr. GRIM. Yes. That is right. That is part of Dodd-Frank.

Mr. SCOTT. Are you also aware that we wrote that and it is clearly written in Section 913 of Dodd-Frank?

Mr. GRIM. Section 913 is the provision that gives the SEC the authority to adopt uniform fiduciary—

Mr. SCOTT. So the issue becomes, why is the Labor Department getting into your bailiwick and doing what they are doing in such a disruptive manner when we clearly—I was here, I was intimately involved in that issue, very intimately involved in the writing of Dodd-Frank, and we expressly put that in.

You regulate the financial advisers. Nobody knows more about investment management than the Securities and Exchange Commission; it is for that purpose.

So, Mr. Grim, I put to you, why is the Labor Department dabbling in this issue and bringing about such great consternation and confusion and threatening the ability, particularly of low-income communities, low-income and low-income small businesses, from getting the kind of financial advice that they need? Why are they doing this?

Mr. GRIM. The question of why DOL is doing it is obviously better directed at DOL. It is sort of up to them what they do. But I would say that we, pursuant to the Section 913 authority that you referenced, the Chair has announced her support for pursuing the uniform fiduciary duty. She has directed staff at the agency, which includes my staff, to develop a recommendation, and that is what we are doing.

Mr. SCOTT. Yes, but you see why the people in this country are getting so fed up with what is happening up here in Washington where you have this kind of invasion of scope of practice and responsibility where we clearly put into one law. That is your responsibility. And then you have another agency coming out of the blue and putting in something else that has tremendous unintended consequences when we are working very hard to get wealth building and to get people to save and to be able to do that in a respectful way.

So I would hope that you would take back words of encouragement from me to Chair Mary Jo White that she needs to press hard and fight for her responsibility and not have it taken away from her from where we gave it to her in this committee when we wrote Dodd-Frank and the President of the United States gave it to her when he signed Dodd-Frank. And the Labor Department is clearly out of bounds. Would you pass that word of encouragement to her? Thank you.

Now, the other question I want to ask you is, you are proposing a rule that is requiring investment advisers to create and maintain transition plans for major disruptions in their businesses. I was wondering if you had any idea of what the overall impact of this would be, particularly on the smaller investment companies?

Mr. GRIM. The impact on the smaller advisers is obviously something that we are studying very carefully as we develop a recommendation for the Commission in the transition area. There are rules on the books right now for investment advisers that were developed post-9/11 about certain transition issues, and what we are trying to do as part of this new rulemaking is evaluate whether there are other types of transition events that those rules should be expanded to cover. And clearly, in so doing, one of the things that we need to understand and ask for public comment and advise the Commission on in recommending whether they propose a rule is the impact on small advisers.

Chairman GARRETT. I thank the gentleman.

Mr. Ross is now recognized for 5 minutes.

Mr. ROSS. Thank you, Mr. Chairman.

Mr. Grim, thank you for being here. It is refreshing to have your testimony because rarely do we have the ones who actually look under the hood and try to make it run on all cylinders and we have a chance to talk to them.

Specifically, and following up on my colleague from Georgia's questioning with regard to the Department of Labor's fiduciary definition, we are giving rise to a whole new cause of action. We are creating a situation that will eliminate the possibility to have the small investors to have adequate and appropriate advice.

My question to you is, to what degree has the SEC contacted you and advised you or you advised them as to what would be the appropriate response to that in terms of the rulemaking that the SEC is going through on a fiduciary rule?

Mr. GRIM. So, the DOL—

Mr. ROSS. They have reached out to you, right? They are looking to you? You are the technical expert here.

Mr. GRIM. We have provided our subject matter expertise to them in conjunction with their development of the rule. I think that what we are doing as part of that is talking to them about our take on potential impacts on investors.

Mr. ROSS. And the impact, for example, on fair compensation as opposed to reasonable compensation, and if the SEC comes down, has a different definition for fair compensation as opposed to the reasonable compensation that can be charged, there is going to be a conflict there, how do you resolve that between the two rules?

Mr. GRIM. One of the issues in the fiduciary debate, whether it is the DOL side of it or the SEC side of it, is absolutely compensation and fee structure. Right now, investors have access to an investment adviser compensation structure, which is typically assets under management. On the broker side, it is typically Commission-based. And as we have studied potential impacts of—as part of the SEC rulemaking process, we have been very focused on making—in developing a recommendation for the Commission, being very conscious of those compensation issues.

Mr. ROSS. Reasonable compensation is important, and I think a lot of my friends in this industry have built a career, and they, of course, have a livelihood that is dependent upon their investors being successful. And so I would think that they are more incentivized to give the proper advice than would be some bureau-

crat in Washington, D.C., telling what they can charge or can't charge and what advice they can and can't give.

Let's talk briefly about FSOC's review of asset managers, because I think that is important. I have listened to your testimony today, and I can't really glean from the fact that you may believe that asset managers are really systemically important financial institutions. Am I wrong on that?

Mr. GRIM. I think the way that FSOC—

Mr. ROSS. Those are conduits. They are really conduits. They are managing money. They are managing assets.

Mr. GRIM. Ultimately, the determination of whether an asset manager is systemic is up to FSOC.

Mr. ROSS. But has FSOC reached out to you? Let's face it, they need to be looking to where the best expertise is, and I am assuming from your testimony and your background that is you. Have they reached out to you and said, "Hey, what do you think is good criteria to determine whether an asset manager is a SIFI?"

Mr. GRIM. Chair White has been very involved, as I understand it, in—

Mr. ROSS. Let me ask you more directly: Do you have an opinion, based on your experience, as to what it would take, what criteria would need to be fulfilled in order to constitute an asset manager as a SIFI?

Mr. GRIM. I think that I would say it is a little too early to say. I think right now the focus—

Mr. ROSS. But if there is—there has to be some criteria. It can't just be such a subjective labeling that you simply say, "Okay, this is what you are and we can't justify it, but good luck getting out of it," which is what the state of the law seems to be right now.

So, again, you are the expert, would you have an opinion as to what it would take in order to justify the labeling of an asset manager as a SIFI?

Mr. GRIM. I think it is fair to say that if that determination is going to be made, it would be important to have criteria in place. But right now, of course, the focus at FSOC has been on this activities and products.

Mr. ROSS. Would it not also be good, if there is such criteria, that it be allowed to be shared with the asset manager so that they can make corrective action to make sure that they either don't become labeled as such or at least have an exit ramp so they can get out of that labeling over a period of time? In other words, transparency in the criteria application.

Mr. GRIM. Again, I would say, obviously that is going to be up to FSOC.

Mr. ROSS. Again, you are the expert, just in your opinion, wouldn't that not be good?

Mr. GRIM. I think in my—

Mr. ROSS. In terms of due process, would it not be good?

Mr. GRIM. In my opinion, I think that we just—right now the focus hasn't been on designation.

Mr. ROSS. Just say, yes, it is okay.

Mr. GRIM. It has been activities. And I think that has been a shift consistent with how the SEC—

Mr. ROSS. Thank you, Mr. Grim. My time is up.

Mr. GRIM. Thank you.

Mr. ROSS. I yield back.

Chairman GARRETT. The gentleman yields back.

Mr. Carney?

Mr. CARNEY. Thank you, Mr. Chairman.

Thank you, Mr. Grim, for coming in today and for answering the questions that we have.

I was part of a group of members of the committee on this side of the aisle, I think, obviously, I think it was also a bipartisan effort to encourage the Department of Labor and the SEC to develop the fiduciary standard, uniform fiduciary rule together in a consistent kind of way. That didn't happen. That was several years ago. And the Department of Labor has proposed its rule and they are taking a lot of feedback. They are getting a lot of input.

And you are in the process, I understand what you have said and the information that I have, in developing the standard from the SEC's perspective. Is that right? We have had a lot of conversation about it over the last—

Mr. GRIM. Yes, that is right.

Mr. CARNEY. —hour or so. Could you give me a timetable for that? You mentioned you are doing a study now. What does that study look like, and what is your timetable?

Mr. GRIM. I think the timetable will ultimately be up to the Commission to vote on the rule. I think that our direction from the Chair has been to develop a recommendation for the Commission's consideration, and that is what we are doing. We are studying very hard some of these impact questions that we have been talking about here because we want to fashion the recommendation in the best way possible for investors and—

Mr. CARNEY. Do you have a sense as to how long that is going to take before you will have a recommendation ready?

Mr. GRIM. I don't.

Mr. CARNEY. The reason I ask the question is because the Department of Labor has its proposal out, and it is getting a lot of feedback. Have you looked at that? I guess you have because you are providing some technical advice and expertise for them, right?

Mr. GRIM. Yes, I am aware of it.

Mr. CARNEY. What do you think? What do you think of the best interest contract and some of the things that are in it? There has been some concern raised about process-wise, how it would all work. Have you looked at those?

Mr. GRIM. I do know that the Labor Department has gotten a lot of comments on that issue and a number of other issues with its proposal. I think our focus, the SEC staff focus on providing its comment or expertise on the proposal has been around potential impacts of choices that they are making in—

Mr. CARNEY. Is your sense that what they have proposed, and given the feedback they have gotten and their expressions of willingness to make certain changes, do you think they are heading in the same direction of where your recommendation will go to the SEC?

Mr. GRIM. I honestly don't know.

Mr. CARNEY. Part of the reason for our letter in the first instances was that you didn't have two widely differing approaches

to this really important uniform—the whole point of it was to get uniformity, right, not to have a separate set of rules apply to different groups of people.

Mr. GRIM. I would point out that ERISA and the Investment Advisers Act, in terms of fiduciary, already have differing approaches—

Mr. CARNEY. Right.

Mr. GRIM. —to what our fiduciary duty does, so that is something that has to be considered as part of this whole thing.

Mr. CARNEY. One of the concerns that has been raised is that small balance accounts will be orphaned because of the changes maybe in compensation allowances would mean that small accounts would be orphaned. Is that something that you are looking—the people who have those accounts wouldn't get any advice, is that something that you are looking at as well in your analysis?

Mr. GRIM. That is something that is very important to us for sure as part of our effort.

Mr. CARNEY. You have the, potentially, the small IRAs under your jurisdiction, right?

Mr. GRIM. What we did both as part of the study that the SEC staff provided to Congress 6 months after Dodd-Frank and in the request for information that we issued to the public a couple of years after that, we have been asking for all kinds of data on—well, a number of issues, but that issue in particular. And my staff, Division of Trading and Market staff, which is the broker-dealer experts, and our Division of Economic and Risk Analysis, our economic experts, we are all looking at that.

Mr. CARNEY. One of the responses that we heard is that there will be new models will emerge in the marketplace. What is your view of that? And it is already happening, by the way.

Mr. GRIM. Yes, I think it is a little too early to say. Obviously, we are just developing our recommendation. So, it is going to be a little too early to say since our recommendation hasn't even been voted on by the Commission.

Mr. CARNEY. Thank you. Good luck with it.

I yield back.

Chairman GARRETT. The gentleman yields back.

Mr. Huizenga?

Mr. HUIZENGA. Thank you, Mr. Chairman.

Quickly, I want to talk about proxy advisory firms, but I do want a quick clarification. When asked by my colleague from Florida about the Department of Labor and the fiduciary standards and about your involvement and whether the Department of Labor had asked for help, you said, "We have shared the information." Did the DOL actually ask you proactively for that help?

Mr. GRIM. Yes, I think so.

Mr. HUIZENGA. Okay. All right. Because I can share information with a lot of my constituents or share information with kind of anybody and that means I just sent the email or I sent it and I don't where it went. Do we know who it actually went to at DOL?

Mr. GRIM. I don't know the details, but I do know that there has been—

Mr. HUIZENGA. Okay. I am going to do a follow-up written question on that because I would like to know who actually requested it and then who sent it and who received it. So thank you.

The two largest proxy advisory firms together control about 90 percent of the proxy advisory industry. In your opinion, do you believe the SEC's rule adopted in 2003 which permits an institutional adviser to rely on an "independent third party" is still appropriate, given that statistic?

Mr. GRIM. The Commission and the Division have been very focused on proxy advisory firms. In recent years we had a roundtable, not too long ago, where we brought in different stakeholders to share their views, and got a lot of good public comment. And subsequent to that, staff in my Division, as well as staff in the Division of Corporation Finance, sort of jointly put together a staff bulletin on some of the issues around proxy advisory firms.

The focus of that guidance has been on a couple of different things. One is that the proxy advisory firms that you mentioned, how they disclose their conflicts. And then another piece of it is how investment advisers who use proxy advisory firms oversee those proxy advisers.

Mr. HUIZENGA. Could you explain how? Because I got a quote in here, so from that bulletin, I believe, you are talking about in considering whether to obtain the assistance of a proxy advisory firm, an investor adviser should ascertain the proxy advisory firm's "capacity and competence to adequately analyze proxy issues," and "identify and address any conflicts of interest?"

Exactly what does that mean, though? What do you mean by that?

Mr. GRIM. I think there have been concerns expressed about investment advisers completely outsourcing to these proxy advisory firms their proxy voting responsibility. And I think the point of that guidance is to provide SEC staff views on what advisers should be thinking about should they choose to employ a proxy advisory firm.

Mr. HUIZENGA. Do you clearly do that, though, in that bulletin? That seems to have brought some question to that.

Mr. GRIM. I think it is pretty clear.

Mr. HUIZENGA. Clarity is in the eye of the beholder? All right.

Mr. GRIM. Yes, right.

Mr. HUIZENGA. And do you believe that the independence of a proxy adviser is also important for an investment adviser to consider when considering whether to obtain the assistance of a proxy advisory firm? There has been a lot of debate about these firms and their inherent conflicts of interest, as you have kind of been pointing out, and are you concerned that it is not appropriate for investment advisers to use these proxy firms as independent third parties when developing recommendations for their proxy voting?

Mr. GRIM. Yes, I think it is, as that guidance that we are talking about pointed out, I think it is important that with respect to proxy advisory firms they provide good disclosure about material conflicts that they have.

Mr. HUIZENGA. So do you believe the SEC needs to provide greater clarity on what it means to be an independent third party?

Mr. GRIM. That is something that we are studying. We just went through the first proxy season subsequent to the issuance of that guidance, so I think we are studying that and the impact of the guidance, and we will decide from there whether more needs to be done.

Mr. HUIZENGA. What is sort of the timeframe then for that analysis? Because, again, that does get to the lack of clarity or clarity as to what an independent third-party proxy is and those definitions. So what sort of timeframe is that on?

Mr. GRIM. It is something that people are focused on right now. Hard to predict when that analysis will be finished.

Mr. HUIZENGA. Is that weeks or months or years?

Mr. GRIM. It is hard to say. I would hope not years. But beyond that, it is hard to say.

Mr. HUIZENGA. Okay. Mr. Chairman, my time has expired. Thank you.

Chairman GARRETT. Thank you.

The gentleman from Connecticut has rejoined us and is recognized for 5 minutes.

Mr. HIMES. Thank you, Mr. Chairman.

And thank you, Mr. Grim, for being with us. I have two categories or two questions, really.

The first is, you note in your testimony that in December of 2014, the FSOC released a notice seeking public comment on risks to financial stability from asset managers, and you further note that the staff has reviewed the comments received. It is a topic of some interest to a lot of us about systemic risk that may or may not be associated with asset managers.

I know you have sort of addressed this a little bit, but I wonder if I could get you to characterize these comments and any initial conclusions or preliminary conclusions or thoughts that you might have on the comments as a whole and whether there is a sense that there is systemic risk emergent from asset managers.

Mr. GRIM. I think as a general matter the comments focused—well, the request for comment asks for comment on sort of a number of different specified activities in the asset management industry, so leverage, liquidity, operational risk, those kind of things. So I think the comments, we got them from a wide—or I should say FSOC got them from a wide range of commenters. And I think that in terms of the work that is ongoing right now at FSOC, they are kind of assessing those comments and figuring out what is the appropriate next step in light of those comments.

Mr. HIMES. Okay. Thank you.

My other question concerns private funds. I worked with Congressman Hurt on some concerns we had in Dodd-Frank about the registration requirement for relatively small funds, and I think Congressman Hurt and I were concerned about two things.

One, those funds obviously are, by definition, held by institutional or other very sophisticated investors. I think we are also concerned about the sheer amount of data that the SEC would receive.

Legislation we put forward ultimately didn't go anywhere, but I was saddened to see, subsequently to that, that the SEC really focused in on the issue of fees, and in particular transparency of fees in that particular community. And I commend the work you have

done in highlighting some absence of transparency, to put it that way, in that community.

So I am wondering—I am very interested in the question of these are obviously fairly complicated partnership agreements. There is an opportunity to hide fees and cash flows and to be less than transparent about what investors are and are not getting back. So I am wondering if I can get you to talk a little bit about whether the issues that have emerged in the private fund arena with respect to transparency on fees, are we talking about a few bad actors? Are we talking about behavior that is systematic in that community, is it common? How concerned is the staff that there is an absence of transparency in those investment vehicles?

Mr. GRIM. As you point out, Dodd-Frank had us, had the SEC develop some rules to implement the registration of a number of private fund advisers, including private equity advisers subsequent to that. So we did those rules, and now our exam staff—that is not me; that is the exam office—have been examining a number of these firms.

And one of the reasons that they are doing so is that although private equity funds are generally sold to sophisticated investors, a number of those investors are pension plans that have your average retail investor worker in them. So there is a retail investor component to them.

In terms of what they have found, I think it is fair to say they found a range of practice. They found on the sort of concerning side of things, they have been very focused on, as you point out, fees, transparency of fees, and they have been—my colleagues in OC have been very public about some of the concerns that they have seen and in certain cases have referred those cases to our Enforcement Division where enforcement has taken action.

Mr. HIMES. I don't have that much time left, but, again, you watch this pretty closely. How concerned should we be that these complicated vehicles, private funds in particular, that an absence of transparency is a structural problem rather than a problem with a number of bad actors?

Mr. GRIM. I think we at the SEC generally, and me specifically, see the benefits of registration under the Advisers Act, the transparency that comes with it, the examination authority that comes with it, and we think that is very important.

Mr. HIMES. Okay. Thank you.

And I yield back the balance of my time.

Chairman GARRETT. The gentleman yields back.

The gentleman from Arizona, Mr. Schweikert, is recognized.

Mr. SCHWEIKERT. Thank you, Mr. Chairman.

Mr. Grim, let me make sort of a circle back just because you have seen in a lot of the conversations here a concern about the harmonization of who regulates whom, but the impact of it. And if I continue to look at the goals or the mission statement of the SEC—protecting investors, maintaining fairness, orderly markets—so when you are actually looking at what many of us believe is a crisis in the retirement world, the number of our brothers and sisters who are heading towards retirement with almost no savings, no assets set aside, when you are promulgating rules, when you are

providing information to the Department of Labor, is there at least the discussion of, hey, accessibility?

This is going to go back to the conversation you and I had before the hearing of other platforms to provide information to get more of our public into the investor class. Do you take into consideration saying, here is the rule sets because we are trying to make everyone safe, but now we have just created another barrier, whether that be cost or bureaucracy, for the population to participate as investors?

Mr. GRIM. Investor access to investment advice is a cornerstone of what we are trying to accomplish with both our SEC work on fiduciary duty, uniform fiduciary duty, and in our sharing of expertise with the Labor Department, a lot of it is around exactly that point.

And we have been very fortunate by publishing our study for Congress, pursuant to Dodd-Frank on the fiduciary duty, and then doing the additional request for information that we did on the uniform fiduciary duty, we have gotten a lot of input about just that point, and we are looking very carefully at it. It is not just the experts in Investment Management on advisers and Trading and Markets on broker-dealers, but our economics, our Division of Economic and Risk Analysis.

Mr. SCHWEIKERT. Mr. Grim, let's sort of do a sidestep, because it is off in a class. Let's say I have someone who is out there working their heart out and they are only setting aside $25 a week, or $50 a week, how do they get advice? We are seeing a number of the investment adviser organizations out there try to bifurcate, saying, "Hey, we are going to give you advice and you can log in using your pocket supercomputer to get information."

Are you working to harmonize that? Is there at least a discussion of, how do we make this information very egalitarian, but not also a cascade of legal events because you didn't put a period in the right place? I have a real concern that as we do more and more of this, one of the outcomes of Dodd-Frank is we have cut off so many people from being able to access advice.

Share with me, does it at least come up in conversation?

Mr. GRIM. Absolutely. So as an example, some of the feedback that is relevant in the fiduciary duty, sort of developing a recommendation for the Commission there is, right, investor testing, investors—there was a study that the SEC had done even prior to Dodd-Frank, I think, that talked about investors and their preferences for the individual who provides them advice, or the type of account that they have, the type of fee structure that they want. All those things are critical to getting at exactly what you are you talking about, which is trying to do what we can to ensure that as many people as possible have—

Mr. SCHWEIKERT. But to that goal, should we as policymakers say, hey, we need to consolidate, we need to harmonize this concept of, the Department of Labor is going to be doing something over here that may create liability in cost structure, the SEC is over here doing things that may change liability in cost structure, SIFI or others, whoever else may be playing, CFPB may even?

Am I creating an environment where our layers of attempting to protect the world are going to lock a lot of our brothers and sisters

away from being able to have even the most basic access to investment retirement information?

Mr. GRIM. I certainly hope not.

Mr. SCHWEIKERT. But it is sort of happening, isn't it?

Mr. GRIM. I think that as we develop our recommendation for what we are going to try to do—

Mr. SCHWEIKERT. As you are building—and I know we are out of time, Mr. Chairman—those, please consider, are we actually creating more barriers to entry than we are actually taking down?

And with that, Mr. Chairman, I yield back.

Chairman GARRETT. The gentleman yields back.

Mr. Hill is now recognized for 5 minutes.

Mr. HILL. Thank you, Mr. Chairman, and Ranking Member Maloney, for this series of hearings.

Mr. Grim, thank you for your public service. And having been a member of the Executive Branch before and testified before Congress before, it is a great opportunity, and I appreciate you doing it. But I also urge you to, while you work for the SEC, to also be free to express your personal view by prefacing it as a personal view because we do want to learn what you think about many of these topics.

And on the subject of the Department of Labor, has the SEC written its fiduciary proposal? Do you have in your office a draft proposal on fiduciary based on all the work you have done for the past 4 years?

Mr. GRIM. We are in the process of developing a recommendation.

Mr. HILL. Would you say you are in the ninth inning of that recommendation or the first inning? Tell me where you are in the process.

Mr. GRIM. I'm sorry, could you say it again?

Mr. HILL. Are you in the ninth inning of developing the recommendation or the first inning? Where are you exactly? It reports to you, so I am sure you have a good feel for where it stands.

Mr. GRIM. I think, I forget exactly the words that Chair White used in announcing her support for and asking the staff for us to develop a recommendation for the Commission. I don't think she used a baseball analogy, which inning it was in—

Mr. HILL. Pick one. I don't care. Tell me where you are in the process.

Mr. GRIM. I think front burner, is what—

Mr. HILL. No, no, no, no, not that it is important. I am asking you, where are you in the development of the process? Are we almost through with it, through with it, waiting on your desk to send it to the Commission for their review? Where are we in the process?

Mr. GRIM. We are developing it for the Commission's consideration.

Mr. HILL. When will it go to the Commission?

Mr. GRIM. As soon as it is ready.

Mr. HILL. When did you start the process?

Mr. GRIM. This issue of uniform duty for brokers and advisers even predates Dodd-Frank. There was discussion about kind of the morphing of the broker-dealer and investment adviser business

even before that. But clearly since Dodd-Frank, the staff, with its SEC staff study that it was required to provide to Congress within 6 months after Dodd-Frank, we did that, so we have been working on it certainly since then.

Mr. HILL. But isn't this—excuse me for interrupting—exactly to Mr. Scott's point, that this is ridiculous that it takes this long? This is an important topic, but we have studied it for 4 years, and now the Department of Labor is preempting your work? Aren't they preempting your work, Mr. Grim, in your personal opinion, not the opinion of the Commission or the Chair?

Mr. GRIM. It is absolutely an important topic but it is complicated, right?

Mr. HILL. Oh, I don't—I have been in this industry for 35 years. I understand the complication. I understand the importance of your work. I am just simply asking you, is the Department of Labor preempting the important work the Commission has done, ordered by the statute of Dodd-Frank? In your view?

Mr. GRIM. DOL and the SEC have different statutes, different mandates. I think that it is up to DOL what to do with ERISA and its statutes.

Mr. HILL. But won't that be confusing for investment advisers and their clients to have these two different competing standards that are actually in conflict with each other in sales practice issues?

Mr. GRIM. That confusion issue is certainly something that we are very focused on and continue to focus on in developing our recommendation.

Mr. HILL. So you are just advocating to the Department of Labor, you are just going to adopt their proposal, because shouldn't you have the preeminent view in this, your expertise?

Mr. GRIM. Labor is—

Mr. HILL. But it will be conflicting, won't it? How could you not have a conflicting standard? Because it is not in keeping with the 1940 Act and all the years. We talked about 70 years of oversight of investment advisers. Won't this be in conflict, the DOL rule and create a lot of confusion?

Mr. GRIM. That is clearly something that we at the SEC are focused on as we develop our recommendation. I don't know. I assume that DOL would be—

Mr. HILL. I will take that as it is confusing, because obviously I think you are confused by that. Let me switch subjects.

Securities receive safe harbors for SEC research purposes. Isn't that right, generally?

Mr. GRIM. Yes.

Mr. HILL. So is there any reason why those same safe harbors shouldn't be extended to exchange traded funds on research for exchange traded funds, in your view?

Mr. GRIM. I would say in response to that, that of course we are very supportive of good research about all kinds of securities.

Mr. HILL. I know you are. I think that goes back to the 1933 and 1934 Acts. But do you agree that those same safe harbors for research on an individual company should be extended to independent research on an exchange traded fund, yes or no?

Mr. GRIM. Because the Act 1933 and the 1934 Act are a little bit—

Mr. HILL. Or the 1940 Act, pick an Act. Don't get—let's not talk about the Acts. Do you believe that the SEC research safe harbor should be afforded to exchange independent research on exchange traded funds?

Mr. GRIM. In looking at research about ETFs, I think we would look at it to encourage it to be good, subject to adequate investor protections. I don't know the details of how taking the 1933 and the 1934 Acts' safe harbors and applying it to our world, I just—I don't know how it would work or not.

Mr. HILL. Thank you, Mr. Chairman, I think.

And I yield back.

Chairman GARRETT. Thank you.

Mr. Hultgren is recognized then for 5 minutes.

Mr. HULTGREN. Thank you, Mr. Chairman.

And thank you, Director Grim. I appreciate you being here, and I appreciate you helping us on these issues.

As I believe all of us know, the Department of Labor clearly is aggressively pushing a new fiduciary standard based upon the Employee Retirement Income Security Act (ERISA). While I heard concerns early on, every day it has become more evident that the Department of Labor has little understanding of the market that it is seeking to regulate or really any perception of the negative implications its proposal have on retail investors, and my sense is they are not willing to listen.

On July 29, 2015, I sent two separate letters to Secretary Perez. It has now been almost 3 months, and he has not responded to me and has done nothing to address the serious concerns of my constituents.

Since Secretary Perez has chosen not to respond to these letters, I wanted to see if I could ask your opinion on these issues. Should the exclusive sale of proprietary products or services be viewed as a violation of a best interest standard?

As you know, this has been proposed by the Department of Labor, but it would be inconsistent with the congressional directive of Section 913 of Dodd-Frank. Labor has proposed that options not be permissible in retirement accounts, but they would continue to be permissible in nonretirement accounts. What are your thoughts on the concept of limiting the types of investments that can be held in retirement accounts?

Mr. GRIM. I would say that with respect to the questions that you directed to Secretary Perez and DOL, I don't know the answers to those. I can tell you that under Section 913, which is directed to the SEC, you are absolutely right, one of the provisions in there involves the issue of sales of proprietary products, and that is one of the considerations that we are looking at very carefully.

We got a lot of public comment around that issue in response to the study that we did subsequent to Dodd-Frank, as well as a further request for information that we did a couple of years later. That has been a very important issue, and that is part of the thing that we are trying to sort out as part of our recommendation.

Mr. HULTGREN. Let me follow up on that then with Section 913 of Dodd-Frank. It provides that the SEC has the authority to adopt

a uniform fiduciary standard for broker-dealers and investment advisers for advice provided to retail investors. In March, Chair White stated the SEC should act to implement such a standard. Since the statement from Chair White, what action has your office taken, and what is the status of your recommendation to the Commission?

Mr. GRIM. After Chair White directed the staff to develop that recommendation, that is essentially directed to at least three parts of the Commission. So it is Investment Management with our expertise about investment advisers; the Division of Trading and Markets, who has expertise on broker dealers; and then our Division of Economic and Risk Analysis, who is sort of integrally involved in all the rulemakings that we do at the Commission now, including on this one, because this one has a number of challenging issues in terms of impacts on investors, impacts on markets, and impacts on products.

We are working very closely. The three divisions are working very closely on the recommendation.

Mr. HULTGREN. It is my opinion, and I think many would share this, certainly my constituents would share this, that politically biased and less informed rulemaking by the Department of Labor, I don't believe, should be putting in place flawed rules. I think it makes much more sense for the SEC, they could do a better job of balancing access to retirement advice and products with consumer protection.

On Friday, March 6th, Secretary Perez told CNBC that, "I have personally met a number of times with Chair White, and our staffs have been working together closely throughout."

I wonder, what are some specific examples of input from the SEC that Labor has used in its public proposals?

Mr. GRIM. I think that in terms of the SEC staff sharing of expertise with Labor Department folks, a lot of what we have been talking about with them has been on impacts, impacts of choices that they are making on investors, on registrants, SEC registrants, on access to products.

Mr. HULTGREN. Let me ask you this really quick. I just have a few seconds left. Do you believe the Department of Labor should suspend its rulemaking until the SEC finalizes its rule? Why or why not?

Mr. GRIM. What DOL does with their rule is up to DOL. My focus at the SEC has been on developing the recommendation on the SEC's fiduciary duty proposal for consideration by our Commission.

Mr. HULTGREN. Thank you for your time.

My time has expired. I yield back.

Chairman GARRETT. I recognize the gentleman from Maine, Mr. Poliquin.

Mr. POLIQUIN. Thank you very much, Mr. Chairman. I appreciate it.

And thank you, Mr. Grim, for being here. I understand this is your first time doing it, and you are doing a great job, and I appreciate it very much.

I don't know if you are familiar with Maine, but not only is it the greatest State in the country and the most beautiful State in

the country, it is also the oldest State in the country. We have the oldest average age in America. And we only have two congressional districts. I represent one, the real Maine, not northern Massachusetts, the real Maine, which is western, central, northern, and down east Maine, and it is highly rural, Mr. Grim. We have folks who are off the grid, we have folks who go through power outages on a regular basis, and a lot of folks who are just not online.

Now, at the SEC, you folks have a proposed rule 30e-3 which would allow investment management firms, primarily mutual funds, I believe, to no longer send out quarterly reports and annual reports to mutual fund investors, instead trying to get folks to log on and print that out or see it online.

Now, here is the problem with that, sir. First of all, 71 percent of investors around the country want to receive paper reports, and this is a study done by you folks, subcontracted by you folks in 2012. Forty-one percent of the seniors have no Internet. My mother is 87. She can barely use a cell phone. She doesn't use the Internet. Seniors also own about one-half, roughly, of all mutual fund assets.

So I am very concerned about making sure the SEC does its job, as you said here several times, of making sure small investors are protected. And the best way to protect them, Mr. Grim, and I think we can agree, is to make sure we continue to allow easy access to financial information in paper form, which our seniors want. Can we agree to that?

Mr. GRIM. The rule that you are referencing was part of a unanimous proposal by the Commission, and I guess I would make a couple of points about it. One is that what the Commission and what we were trying to do with that rule proposal is allow investors to get their disclosure in the way that they prefer it.

Mr. POLIQUIN. Great. And you know something, I agree with you, Mr. Grim. And I want to move on to another topic. And so all I am saying is, let's make it really easy for our seniors who don't want to get it through the Internet to continue to receive it in paper form instead of forcing them to opt in by filling out a form that they lose, they never receive in the mail, and folks have a hard time reading.

So I know you have a lot of influence at the SEC, and I would really appreciate you advocating for that option to make sure our investors get the information they need.

I would like to move on a little bit here. I bet I spend in my congressional office, Mr. Grim, 25 percent of my time talking to taxpayers who want money from the Federal Government. And I always remind them of the same thing: We are borrowing to pay our bills, and we are $18 trillion in debt. Now, on top of that, we have a Social Security system that deals with retirement, of course, that has promised about $15 trillion more than the IOUs that are sitting right now in the trust fund.

This morning I talked to a mom with 3 kids up in Skowhegan, Maine, in the middle of our district. She is working two jobs, her husband probably is also, and I bet, like the rest of our seniors in Maine and across the country, they are scared that Social Security might not be there for them when they need it. So, they are trying to put aside a little bit of money to save.

We have about $24 trillion in retirement savings across the country, as you know. You are in this space. And a lot of this money is being managed in mutual funds and also in 401(k) plans and IRAs, and these asset managers are trying to help out the little investor.

Now, you have probably seen the study that was done not long ago by a fellow by the name of Douglas Holtz-Eakin, who used to be at the CBO, saying that long term, if asset managers are designated as too-big-to-fail, if they have the SIFI designation, that long term, because the cost will be so expensive for them, these rates of return will be about 25 percent less on these retirement savings.

So where is the compassion for the little investor? We are supposed to help these folks.

I want to hear from you, if I may, Mr. Grim, don't you think it is a good idea to expand upon the discussion we have already had here today, that asset managers who are trying to help small investors save for their retirement, knowing that Social Security is in trouble, to not penalize them, so if they don't have any assets on their balance sheet but they are managing money for other small investors, there is no systemic risk to the market?

Would you agree with that? And wouldn't you also agree that it makes sense for asset managers not to be listed as SIFIs?

Mr. GRIM. One of the great things about my job and one of the—just the awesome responsibility of it is some of this stuff that you are talking about, right. There is over $18 trillion in—

Mr. POLIQUIN. Yes.

Mr. GRIM. —registered investment companies. We have over 11,000 advisers with—

Mr. POLIQUIN. Mr. Grim, I am just about out of time. I don't mean to be rude, but when Chair Yellen came here, and Chair White came here, and Secretary Lew came here, I asked them the same question that I am asking you, and they all said, "We are looking at this."

Now, what I heard you saying earlier—I believe I heard this correctly—is that you think it is a good idea and it makes sense—

Mr. GARRETT. If the gentleman could—

Mr. POLIQUIN. —for asset managers not to be list as SIFIs, therefore not penalizing our smaller investor with lower rates of return. Did I hear you correctly, sir?

Mr. GRIM. I think, being that those folks you just mentioned are the members of FSOC, that is kind of where—because they are the ones that—they were the ones that make that determination.

Mr. POLIQUIN. I bet you have an office right next door to Chair White and I bet you can influence her.

Chairman GARRETT. The gentleman's time—

Mr. POLIQUIN. Thank you very much, Mr. Chairman.

And thank you, Mr. Grim.

Chairman GARRETT. Thank you.

I recognize the gentleman from California, Mr. Sherman.

Mr. SHERMAN. I would like to defer to the gentlelady from New York.

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

Let me take this opportunity to thank my colleague, Mr. Sherman, for yielding. And I want to take this opportunity also to thank the ranking member and the chairman for allowing me to participate in this subcommittee hearing, an important one.

I want to raise an issue with you, Mr. Grim, that is very important to hard-working Americans in the U.S. territories, including Puerto Rico. As you may know, Puerto Rico and all U.S. territories are exempted from the Investment Company Act of 1940. And when you look at the history and the Congressional Record, the argument at the time was that these territories were far away and that it will imply more resources.

Recently, it was reported that UBS was underwriting bonds for Puerto Rico's retirement system and then placing these same bonds into mutual funds that were sold to customers on the island. Would this practice be permitted in the 50 States?

Mr. GRIM. You correctly point out that the way the Investment Company Act works right now, there is an exclusion from registration for Puerto Rico and the other territories of the United States. And what that means is that they are exempt from a number of the important investor protections that are in the act, registration, disclosure, examination, and affiliated transaction provisions that apply to your standard mutual fund in the United States.

On your question of the UBS situation, I think it is a little hard to—I don't know the facts well enough to know whether—how those provisions would apply—if they had applied, how they would apply to the UBS facts, but I guess ultimately I would say those affiliated transactions—

Ms. VELAZQUEZ. If UBS in the United States would be allowed to incur in the reckless, abusive behavior that they have done in Puerto Rico?

Mr. GRIM. What is prohibited by the affiliated transaction provisions for investment companies in the United States is purchases and sales between affiliates and the funds, purchases of bonds from affiliated underwriters. So again, I don't know the specifics of the UBS case, but that is the way the provisions work here in the United States for those that are registered under the Investment Company Act.

Ms. VELAZQUEZ. Do you believe that American citizens in Puerto Rico are at a disadvantage because they lack the investor protections of the Investment Act as afforded to those in the 50 States?

Mr. GRIM. My understanding is that funds in Puerto Rico are subject to some kind of an investment company law. I don't know the details of it, so therefore it is hard for me to compare the two laws. But I would say—

Ms. VELAZQUEZ. But the question is simple. In Puerto Rico and the U.S. territories, American citizens who reside on the island of Puerto Rico are exempted from this law, the Investment Act of 1940. My question to you is, do you believe that this loophole should be closed? Since, as you can see, in the Congressional Record it shows that there was not a principal issue at the time, but just the fact of the distance, the cost, the resources.

Do you think we should close that loophole and grant the same investor protections that we afford to every American citizen? Do

you think that veterans in Puerto Rico who go and fight for this country should be afforded the same protections?

Mr. GRIM. I think that the investor protections of the Investment Company Act are critical to all kinds of investors, disclosure, transparency, affiliated transactions. All that stuff is—it is the bedrock of what I do every day, so I believe it in very much.

Ms. VELAZQUEZ. And so that means you believe that we should close this loophole?

Mr. GRIM. I understand that there is some legislative discussion about just that question, whether to close that loophole. My understanding is that the Commission hasn't offered a view on that legislation. But obviously, I am happy to provide our technical expertise on it.

Ms. VELAZQUEZ. I introduced legislation to close that loophole, and I just ask the chairman and the ranking member that we work together so that we can afford the same protection that is provided to every American citizen in the United States and the 50 States to the people of Puerto Rico and the U.S. territories.

I yield back.

Chairman GARRETT. Thank you. The gentlelady yields back.

Mr. Stivers is now recognized.

Mr. STIVERS. Thank you, Mr. Chairman. I appreciate you holding this very important hearing.

And, Mr. Grim, I appreciate you being here. I just wanted to ask you first if it is lonely down there all by yourself?

Mr. GRIM. I have some folks behind me. It makes me feel a little less lonely.

Mr. STIVERS. Okay. I am glad you brought a few friends.

I want to talk about an issue I don't think anybody has talked about. Has anybody talked to you about the potential coming liquidity crisis?

Mr. GRIM. We have touched a bit on the SEC's liquidity proposal.

Mr. STIVERS. Great.

Mr. GRIM. Not more generally.

Mr. STIVERS. So it appears to me that there are multiple forces, business simplification among many of the people you regulate, compliance with the Volcker Rule, and also the fiduciary standard moving a lot of folks who have been market makers out of the space, which could ultimately result in much wider price swings on the same amount of deal flow. And I am curious how much discussion you have had at the SEC around this coming problem that is created when you are focused on the stability of every single company, but not truly market stability.

And you can just tell me you have had a lot of discussion, a little discussion, not much discussion, because they are talking about it in the market.

Mr. GRIM. A lot of discussion.

Mr. STIVERS. Okay. Thank you.

I hope you will take a look at it. I have written a letter to the Office of Financial Research (OFR), asking them to do a study on this, because this is the coming crisis in our capital markets. And whether it is the small investor that is in a 401(k), a large investor, corporations, banks that enter their investments through the capital markets, you are the front door of regulation for a lot of people,

and you need to take a look at this coming crisis because you have the power to solve it, and I hope you are taking it very seriously.

Mr. GRIM. Liquidity is a very important issue to a lot of people for a lot of different reasons. I think with respect to investment management, we have done a couple of different things recently that I would highlight. One, last year there has been—

Mr. STIVERS. I appreciate what you have done, and I have limited time. You haven't done enough. You have not solved the crisis. The crisis is getting worse, not better. I would ask you to take a serious look at it, get the OFR to do a study, do a study of your own, continue to look at this. You are having market makers continue to leave the space. The potential of a coming crisis is there. You have the ability to solve it. I hope you will.

I am going to talk about the DOL fiduciary rule, and one of my fellow Members asked about harmonization efforts. So I wanted to ask you, have you had conversations with the Department of Labor about holding off or suspending its rulemaking until you complete your 913 rulemaking? Because you couldn't tell the gentleman from Arkansas when that would be done. Are you coordinating with the Department of Labor on release dates, yes or no? It is a yes-or-no question. That is all I need.

Mr. GRIM. We have provided our subject matter expertise to DOL on some of the things that are going on in their rule.

Mr. STIVERS. Are you coordinating release dates? Have you asked them to slow down until you can finish your 913 rulemaking so you can release them together, yes or no?

Mr. GRIM. I—

Mr. STIVERS. Would you please take a look at that?

Mr. GRIM. Yes, I can look at it. I don't know the details of—

Mr. STIVERS. And you don't have power over the Department of Labor, but you can ask them. If you haven't asked them—I learned a long time ago, nobody does anything until you ask them. So maybe you should ask them, and then we might not have rules that conflict with each other, because they can be done together, harmonized, and put together. That is what people need and demand of their government, an efficient, effective government.

So I would ask you to go back to the Department of Labor and see if you can coordinate. It is clear to me it has not happened. You don't want to say it has not happened. I understand that. I am not looking to place blame here. There is still time to fix it. Let's try to fix it.

I am curious if what you believe about imposing a fiduciary standard of care, what that will mean to investors with regard to fewer choices and higher costs. Are you willing to acknowledge that investors will have less choices because of the due diligence required of every investment at a fiduciary standard level and the legal liability and all at higher cost because of the cost of that due diligence, yes or no?

Mr. GRIM. I think that is something that is important for us to study, that we have asked for a—

Mr. STIVERS. You don't believe it is true, necessarily? You are studying it.

Mr. GRIM. We haven't finished with our recommendation. The Commission hasn't adopted its—

Mr. STIVERS. It happened in the United Kingdom. Did you see what happened there?

Mr. GRIM. I didn't hear.

Mr. STIVERS. Have you studied what happened when the United Kingdom opposed this standard? Did it result in fewer choices and higher costs? It did. Please look at that. I hope you will continue to study it.

These aren't hard questions. I am sorry you don't know the answers to them. But I hope you will look at it. I hope you will coordinate and try to harmonize these rules and do what is right for the American people.

I appreciate that you have a hard job. I know you have competing interests. You have a lot of information that you have to look at. But please do what is right for small investors in this country and try to harmonize these rules—

Mr. HURT [presiding]. The gentleman's time has expired.

Mr. STIVERS. —and make them not as painful with costs and fewer choices. Let's not hurt mom and pop all across this country.

I yield back the balance of my time, Mr. Chairman.

Mr. HURT. The gentleman's time has expired.

The Chair now recognizes Mr. Sherman for a period of 5 minutes.

Mr. SHERMAN. I want to pick up on the brilliant comments of Mr. Stivers. You have to work to harmonize these rules. It is absolutely absurd to think that we would have one set of rules applying to me because I have my money in an IRA and no rules, perhaps, or another set of rules applying to my mother who inherited some money from my father.

And, in fact, what you have is a circumstance where you are going to have greater restrictions or greater protections on baby boomers who have their money in IRAs, and weaker restrictions and more freedom for people in their eighties and nineties who never know from IRAs and 401(k)s.

So it ought to be the same rule or, if anything, the stricter rule ought to apply to the non-IRA accounts. And it is the SEC that has the expertise so I hope you will talk to your friends in the Department of Labor.

In your prepared testimony, you mentioned the proposed rule to permit asset managers to provide shareholder reports electronically instead of on paper. On behalf of America's trees, I want to commend you for that and push it forward. I think it will be better for the investor because, speaking as an investor, I am constantly losing my reports. If they are electronic, I will have them forever, and I can switch back at them. I will never do that during a hearing, but at other times when I have my iPad, they are right there.

As to a SIFI designation, you also mentioned that in your report, do you think you have enough tools to determine whether an asset manager is systemically important, Mr. Grim?

Mr. GRIM. Dodd-Frank set up the tools. The tools are for FSOC to determine whether something is systemic as opposed to the SEC. But I think that is where the tools are.

Mr. SHERMAN. Going to the liquidity rules, you are going to have six buckets. Is there going to be a requirement that the fund have

at least 50 percent of its assets in bucket one or bucket two, or is this just a disclosure, or is this a requirement?

Mr. GRIM. On the liquidity proposal that you reference, you are right to note that one of the elements of the rule is it proposes that there would be six buckets. Those buckets would be disclosed and transparent, so that is an essential part of the rule. There is another part of the rule that codifies some guidance that has been in existence for a while that would cap the amount of illiquid assets that a fund could hold.

Mr. SHERMAN. Is illiquid bucket six or bucket five and six or buckets two through—or are these rules just separate? Do the buckets have anything to do with the 15 percent requirement?

Mr. GRIM. It is a separate requirement.

Mr. SHERMAN. A separate requirement.

I am a bit concerned about the idea of using third parties because I have seen what happened in the bond rating area, where they basically created the greatest economic catastrophe of our lifetimes, because the bond rating agency is selected by the issuer.

If we are going to have these outside firms come in, are they going to be selected by the fund or would the SEC have a panel and assign the way, say, bankruptcy trustees are assigned from a panel? And wouldn't my grades have been much better if I could have determined which professor graded my paper and paid him?

Mr. GRIM. With respect to third-party compliance reviews, Chair White has directed us, the staff, to come up with a recommendation on that point. One of the—

Mr. SHERMAN. I recommend that when you do that, look at the Frank and Sherman amendment to Dodd-Frank as originally proposed. We had a good system for assigning credit rating agencies. The SEC board ignored it there. But it is a system you may want to pick up. I am not saying this will please your board. Since they ignored it when they were required to follow it, they may not want you to follow it voluntarily.

But the idea that you are going to have an outside grader who is paid and selected by the people that they are grading didn't work out so well in 2008. And you ought to take a look at a system by which those doing the grading can't become more profitable by putting out the word that they are easy graders.

Mr. HURT. The gentleman's time has expired. I thank the gentleman.

The Chair now recognizes the chairman of the House Foreign Affairs Committee, Mr. Royce, for a period of 5 minutes.

Mr. ROYCE. Thank you.

And thank you, Director Grim.

The OFR's asset management report included a number of factual errors. For example, the report listed an incorrect name for Fidelity's highest-level asset management entity and misreported the amount of its assets under management. The report improperly described Vanguard's structure. The report misrepresented the amount of assets under management for PIMCO.

Thankfully here, the SEC provided stakeholders an opportunity in this situation to point out these mistakes, along with substantive concerns that the SEC had about the report. Do you think some of these mistakes could have been avoided if the OFR worked

more closely with the financial supervisors and regulators, those, after all, with the expertise in these areas, and maybe also opened up their work for public comment?

Mr. GRIM. With respect to the OFR report, SEC staff provided some comments to the OFR on it. It was the OFR report. They chose to take some of our comments. They chose not to take some other comments. I think, ultimately, it was up to OFR to decide how the final report looked.

Mr. ROYCE. You may know that Congressman Patrick Murphy and I have introduced a bipartisan bill, the Office of Financial Research Accountability Act, to address these issues, and the bill requires the OFR to submit for public notice and comment an annual report that details the Office's work for the upcoming year. Additionally, this bill requires the OFR to coordinate with financial regulators when they conduct future studies.

While the OFR opposes this extra, what I would call transparency, I am hopeful we will see widespread support for these balanced changes going forward.

Let me ask you another question, Director Grim, and this follows up on the staff legal bulletin on proxy voting that Chairman Garrett and Mr. Huizenga raised earlier. Should proxy advisory firms not be held to the same sort of accountability on corporate reporting and transparency as the SEC requires of the publicly traded companies that they advise on?

Mr. GRIM. With respect to proxy advisory firms and the guidance that the staff did issue, I think it was focused on addressing two important issues as a general matter. One is, with respect to the proxy advisory firms themselves, doing what we can to encourage good disclosure of material conflicts of interest by those proxy advisory firms. The second focus of the guidance was on investment advisers and how they use proxy advisory firms, making sure that their oversight of the proxy advisers is robust and appropriate.

Mr. ROYCE. I saw the bulletin. One of the things it brought to mind was whether or not we shouldn't instead be having the Commission have a formal rulemaking on this. And I say it for these reasons. First, when we get to this question of what are the standards of performance, we have a situation where you have two entities and they dominate here, clearly, over 90 percent of the market. And we, on top of it, have a situation where there are reports I would think would be subject to public scrutiny after those reports are prepared. But we don't have that.

So I think taking it higher than a staff legal bulletin and taking it to basically a question of rulemaking on this by the Commission, is something I would suggest and just sort of get your feedback on that.

Mr. GRIM. I think where we are right now is, after the staff issued that guidance, we have had a proxy season run. And we have, my colleagues in the examination unit have been doing or are planning to do some exams. And so we are trying to gather some more feedback on the status, and then we will decide whether further action, including potential rulemaking, is necessary.

Mr. ROYCE. The rules of the road seem to change when someone has an interest. And I guarantee you, when you have a situation where you have two entities with 90 percent of the market and the

kinds of questions that have been called up over this performance, I think at the end of the day we are going to need rulemaking on it.

But thank you very much. I appreciate your testimony today.

Mr. HURT. The gentleman's time has expired.

Mr. Grim, thank you very much for appearing before this committee today.

The Chair notes that some Members may have additional questions for this witness, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to this witness and to place his responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

The hearing is adjourned.

[Whereupon, at 11:23 a.m., the hearing was adjourned.]

A P P E N D I X

October 23, 2015

Testimony on "Oversight of the SEC's Division of Investment Management"

David W. Grim, Director
Division of Investment Management
U.S. Securities and Exchange Commission

Before the

United States House of Representatives Committee on Financial Services
Subcommittee on Capital Markets and Government Sponsored Enterprises

October 23, 2015

Chairman Garrett, Ranking Member Maloney, and Members of the Subcommittee:

Thank you for inviting me to testify today on behalf of the U.S. Securities and Exchange Commission (Commission) about the Division of Investment Management's (Division) activities and responsibilities.

The tripartite mission of the Commission is to protect investors, maintain fair, orderly and efficient markets, and facilitate capital formation. The Division promotes this mission through regulating the asset management industry. A primary function of the Division is to administer the Investment Company Act of 1940 (Investment Company Act) and Investment Advisers Act of 1940 (Investment Advisers Act) and to develop regulatory policy for both investment companies – including mutual funds, closed-end funds,[1] business development companies,[2] unit investment trusts (UITs),[3] and exchange-traded funds (ETFs)[4] – and investment advisers, all of which play a major role in the lives of Americans and our national economy.

Investors, in particular retail investors, have increasingly come to rely on investments in mutual funds to reach their financial goals. At the end of 2014, more than 53 million households

[1] Closed-end funds generally do not continuously offer their shares for sale and are not required to repurchase or redeem them. Rather, they sell a fixed number of shares at one time (in an initial public offering), after which the shares typically trade on a secondary market, such as the New York Stock Exchange or the Nasdaq Stock Market.

[2] Congress created business development companies in 1980 as a specialized type of closed-end investment company (*i.e.*, a fund that is not required to repurchase or redeem its securities) whose principal activities consist of investing in, and providing managerial assistance to, small, growing, or financially troubled domestic businesses.

[3] A UIT is a type of investment company which (a) is organized under a trust indenture contract of custodianship or agency or similar instrument; (b) does not have a board of directors; and (c) issues only redeemable securities.

[4] Like mutual funds, ETFs offer investors a way to pool their money in a fund that makes investments in stocks, bonds, or other assets and, in return, to receive an interest in that investment pool. Unlike mutual funds, however, ETF shares are traded on a national stock exchange and at market prices that may or may not be the same as the net asset value of the shares, that is, the value of the ETF's assets minus its liabilities divided by the number of shares outstanding . Some ETFs track the performance of specific U.S. equity indexes, while others track indexes of fixed-income instruments and foreign securities. In addition, many newer ETFs are actively managed – that is, they do not merely seek to passively track an index, and instead seek to achieve a specified investment objective using an active investment strategy.

-- more than 43 percent of all U.S. households – owned mutual funds. Mutual funds are the largest segment of the investment company industry, accounting for 87 percent of the over $18.7 trillion in total investment company assets. Assets in mutual funds have grown from $94.5 billion at the end of 1979 to $16.3 trillion at July 31, 2015, a more than 173 fold increase. Over the same period, the number of mutual fund portfolios has increased from 526 to 8,059.

Like mutual funds, ETFs also have become increasingly popular as investment vehicles for both retail and institutional investors. ETFs have grown rapidly in recent years, with assets in ETFs increasing from $300.8 billion at the end of 2005 to $2.1 trillion at July 31, 2015, a more than 600% increase.

Protecting investors through the regulation of registered investment advisers is another of the Division's crucial roles. As of October 1, 2015, there were 11,986 investment advisers registered with the Commission reporting approximately $66.9 trillion in regulatory assets under management, which was an 8 percent increase from the beginning of fiscal year 2015. Approximately 60 percent of these advisers provide investment advice to individuals. Beyond this, approximately 37 percent of these SEC-registered investment advisers provide investment advice to approximately 29,000 private funds (e.g., hedge funds, private equity funds, and venture capital funds) with gross assets of about $10.4 trillion.

In addition to registered investment advisers, the Commission also receives reports from approximately 3,047 exempt reporting advisers. These are advisers whose only clients are private funds and are exempt from registration with the Commission. These advisers manage over 10,000 private funds accounting for $2.3 trillion.

The Division carries out the Commission's mission through its dedicated staff, which includes lawyers, accountants, quantitative analysts, economists, industry experts and other employees primarily in Washington, DC, but also located in SEC Regional Offices in New York, Philadelphia, and Chicago. The four core activities of the Division are: (1) crafting rulemaking recommendations to the Commission on matters within the Division's expertise; (2) reviewing fund filings; (3) providing interpretive and other advice to the asset management industry and the public about the securities laws and corresponding regulations; and (4) monitoring risks in the asset management industry. Below is an overview of those activities.

Recent Investment Management Rulemaking Initiatives

Money Market Fund Reform

In July 2014, the Commission adopted significant reforms to the rules governing money market mutual funds. The amendments were intended to reduce the risk of runs in money market funds, provide important tools to help further protect investors and the financial system in a crisis, and enhance the transparency and fairness of these products for America's investors.

Under the new rules, "institutional prime" money market funds[5] will be required to maintain a floating net asset value (NAV) based on the current market value of the securities in

[5] These funds include all money market funds except retail and government money market funds.

their portfolios. The rules also provide new tools for boards of directors of money market funds to directly address heightened redemptions in a fund. Specifically, fund boards will be able to impose liquidity fees or to suspend redemptions temporarily, also known as "gates," if a fund's level of weekly liquid assets falls below certain thresholds. The Commission provided for approximately a two-year transition period for these new provisions, with the rules becoming effective in October 2016, to enable both funds and investors time to fully adapt their systems, operations, and investing practices.

The new rules also enhance money market fund disclosure requirements. Specifically, money market funds will be required to promptly disclose certain significant events, including the imposition or removal of fees or gates, portfolio security defaults, and instances of sponsor support. In addition, money market funds will be required to disclose additional key information on their website on a daily basis, including funds' liquidity levels, net shareholder flows, and market-based net asset values per share.

In September 2015, the Commission also adopted amendments related to the removal of credit ratings references in rule 2a-7, the primary rule that governs money market funds under the Investment Company Act and in Form N-MFP, the money market fund portfolio disclosure form. The amendments give effect to section 939A of the Dodd Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).

Investment Company Reporting Modernization & Amendments to Form ADV and Investment Advisers Act Rules

The Commission's rules should evolve with developments in the asset management industry. To that end, on May 20, 2015, the Commission proposed new rules and forms as well as amendments to its rules and forms to modernize the reporting and disclosure of information by registered investment companies.

If the proposed rules are adopted, a new monthly portfolio reporting form, Form N-PORT, would require registered funds other than money market funds to provide portfolio-wide and position-level holdings data to the Commission on a monthly basis. Information contained on reports for the last month of each fund's fiscal quarter would be available to the public. In light of the proposed Form N-PORT, the Commission proposed rescinding Form N-Q, on which funds currently report certain portfolio holdings for the first and third fiscal quarters.

A new annual reporting form, Form N-CEN, would be established if the proposed rules are adopted. It would require registered funds to annually report certain census-type information to the Commission and would replace the form currently used to report fund census information (Form N-SAR). The form would streamline and update information reported to the Commission to reflect current information needs, such as requiring more information on ETFs and securities lending. Reports would be filed annually within 60 days of the end of the fund's fiscal year, rather than semi-annually as is currently required by Form N-SAR for most funds.

If adopted, funds would report portfolio and census information in a structured data format, which would improve the ability of the Commission and the public both to aggregate and

analyze information across all funds and to link the reported information with information from other sources. The Commission currently receives this type of reporting for: (1) money market funds through the publicly available Form N-MFP; and (2) certain private funds through Form PF, which is reported to the Commission.

The proposed amendments also would require enhanced and standardized financial statement disclosures. For example, the proposed amendments would include requirements to provide: derivatives-related information in financial statements similar to what would be required in the proposed monthly portfolio holdings reports;[6] and information in the notes to the financial statements relating to a fund's securities lending activities.

The proposed amendments also would permit mutual funds and other registered investment companies to provide shareholder reports and the funds' quarterly portfolio holdings for the past year by making them accessible on their website, unless shareholders specifically request paper copies. Funds currently satisfy delivery requirements by printing and mailing shareholder reports unless investors have affirmatively requested electronic delivery.[7]

Also on May 20, 2015, the Commission proposed amendments to Form ADV, the primary investment adviser reporting and disclosure form. The amendments are designed to: (1) provide additional information regarding advisers, including information about their separately managed account business; and (2) address issues that staff has identified since the Commission made significant changes to Form ADV in 2011.[8] The amendments also would incorporate a method for private fund adviser entities operating a single advisory business to register using a single Form ADV.

In addition, the proposed amendments would, if adopted, require advisers to maintain records of the calculation of performance information that is distributed to any person. Currently, advisers are required to maintain performance information that is distributed to 10 or more persons. The proposed amendments also would require advisers to maintain communications related to performance or rate of return of accounts and securities recommendations.

With respect to all of the proposed amendments, the Commission has received substantial public comment. These comments will be analyzed in connection with the staff's development of recommendations to the Commission on final rules.

Liquidity Management Programs for Funds

---

[6] Current requirements do not include specific information for many types of derivatives, such as swaps, futures, and forwards.

[7] Under the proposed rule, funds would be required to send notices to investors regarding the change to electronic delivery and online availability of shareholder reports on a regular basis, and the notices would need to inform investors how to receive free of charge paper copies of shareholder reports.

[8] For example, the proposals would, if adopted, require aggregate information related to assets held and use of borrowings and derivatives in separately managed accounts and provide additional information about an adviser's advisory business, including branch office operations and the use of social media.

In addition to these proposals, to further address developments in the asset management industry, on September 22, 2015, the Commission proposed a new rule that if adopted would require open-end funds to adopt and implement liquidity management programs. The proposed amendments also, if adopted, would permit mutual funds to use "swing pricing," and would enhance disclosure regarding fund liquidity and redemption practices.

Specifically, the proposed rule would require mutual funds and other open-end management investment companies, including ETFs, to have a liquidity risk management program. The proposed rule would exclude money market funds from the requirements because they are already subject to liquidity requirements tailored to their particular structure and operations.

The Commission also proposed amendments that if adopted would permit, but not require, open-end funds (except money market funds or ETFs) to use "swing pricing." Swing pricing is the process of reflecting in a fund's net asset value the costs associated with the trading activity of the fund occasioned by shareholders' redemptions and purchases in order to pass those costs on to the purchasing and redeeming shareholders. Additionally, proposed amendments to the registration form used by open-end investment companies (Form N-1A) would, if adopted, require funds to disclose swing pricing, if applicable, and the methods used by funds to meet redemptions.

Proposed amendments to the census reporting form the Commission proposed in May 2015 also would require funds to disclose information regarding committed lines of credit, interfund borrowing and lending, and swing pricing.

The comment period for the proposed rules will be open through January 13, 2016.

Other Potential Rules to Enhance Risk Monitoring and Regulatory Safeguards

At the direction of the Chair, the Division also is working on initiatives aimed at helping to ensure the Commission's regulatory program is fully addressing the increasingly complex portfolio composition and operations of the asset management industry. These initiatives include potential new rules concerning the following:

- *Use of Derivatives by Investment Companies* – The Division, in close consultation with staff in the SEC's Division of Economic and Risk Analysis, is considering recommending that the Commission propose new requirements related to the use of derivatives by funds, including measures to appropriately limit the leverage these instruments may create, and measures to enhance risk management programs for such activities.

- *Transition Plans for Investment Advisers* – The Division also is considering recommending that the Commission propose a new requirement that investment advisers registered with the Commission create and maintain transition plans to prepare for a major disruption in their business.

- *Stress Testing for Large Investment Advisers and Large Investment Companies* – In addition, the Division is considering recommending that the Commission propose new requirements for stress testing by large investment advisers and large investment companies. Such rules would implement section 165(i) of the Dodd Frank Act.

- *Third-Party Compliance Reviews* – Division staff, working in conjunction with the staff from the SEC's Office of Compliance Inspections and Examinations (OCIE), is developing a recommendation for the Commission's consideration that, if proposed and adopted, would establish a program of third-party compliance reviews for registered investment advisers. The reviews would not replace examinations conducted by OCIE, but would supplement them in order to improve compliance by registered investment advisers.

Personalized Investment Advice Standard of Conduct

Section 913 of the Dodd Frank Act grants the Commission authority under the Exchange Act and Advisers Act to adopt rules establishing a uniform fiduciary standard of conduct for broker-dealers and investment advisers when providing personalized investment advice about securities to retail customers. The Commission issued a public request for information to obtain further data and other information to assist it in determining whether or not to use the authority provided under section 913 of the Dodd Frank Act.

In March of this year, Chair White expressed her view that the SEC should act to implement a uniform fiduciary standard of conduct for broker-dealers and investment advisers when providing personalized investment advice about securities to retail customers, and directed staff to prepare such a recommendation for the Commission's consideration. The issue is a complicated one that has been contemplated in prior years without a rule being proposed, and whether a rule is ultimately proposed and adopted depends on further analysis and action by the full Commission.

Target Date Funds

On April 3, 2014, the Commission issued a release reopening the period for public comment on proposed rule amendments concerning target date fund names and marketing. The release requested additional comment on a 2010 Commission proposal to require that certain marketing materials for target date retirement funds provide better information to investors and reduce the potential for investors to be confused or misled. The Division is continuing to evaluate the comment letters submitted to the Commission and is considering what further actions may be appropriate.

Reviewing Fund Filings and Disclosures

In addition to rulemaking, Division staff helps fulfill the Commission's mission by reviewing and commenting on the numerous prospectuses, proxy statements, and other

disclosure documents filed by mutual funds, ETFs, closed-end funds, business development companies, variable insurance products issuers, and UITs each year.

The staff reviews new portfolios of open-end funds, closed-end funds and UITs, and new insurance contracts.[9] The staff also examines certain post-effective amendments that contain material changes in disclosure or in fund operations, as well as certain preliminary proxy statements. Additionally, the staff continues to fulfill the Sarbanes-Oxley Act requirement to review investment company issuer accounting statements at least once every three years.

In the course of a filing review, Division staff will conduct an evaluation of a fund's disclosure and will, as appropriate, issue comments to elicit better compliance with applicable disclosure requirements, as well as other applicable statutory and rule requirements under the federal securities laws. In response to Division staff comments, a fund may amend its disclosures to provide additional or enhanced information in the filing that is under review. A fund may also provide Division staff with information that supplements what is contained in the filing so staff can better understand the fund's disclosure decisions.

Division staff coordinates with other offices and divisions within the Commission on complex or interconnected issues that arise within these reviews. Division staff also identifies new and recurring issues that may need new policy guidance. Where appropriate, Division staff refers matters to the SEC's Office of Compliance Inspections and Examinations or the Division of Enforcement. Division staff also continues to seek to improve the quality and consistency of our comments, as well as the overall effectiveness of our filing review process.

To increase the transparency of the filing review process, after Division staff completes its review of a filing, its comments and fund responses to those comments are made public on the Commission's website.

As part of the filing review process, Division staff also is responsible for: (1) providing advice to help ensure the full and fair disclosure of financial information by investment companies and issuers of variable insurance products; (2) rendering interpretations as to the meaning and application of rules relating to the form and content of financial statements required to be filed by investment companies, issuers of variable insurance products, and investment advisers; and (3) recommending the establishment, in collaboration with the other divisions and offices of the Commission, of sound and uniform standards of auditing and accounting procedures and practices with respect to investment companies, variable insurance products, and investment advisers.

Guidance & Exemptive Relief

The Division also is responsible for issuing no-action letters, interpretive letters, and other guidance under both the Investment Company Act and the Investment Advisers Act (and their related rules), as well as under other federal securities laws that affect the asset management industry. In addition, the Division provides counsel to the Commission, SEC staff, and non-SEC

[9] Division staff reviews all new fund and UIT portfolios except those for which the disclosure is substantially identical to disclosures previously reviewed by the staff.

persons on matters involving the interplay of the Investment Company Act and Investment Advisers Act (and their related rules) with other federal and state laws.

Division staff also reviews all enforcement matters that concern investment companies and investment advisers. In carrying out this function, Division staff has extensive contact with other divisions and offices, including the Commission's regional offices and enforcement and examination staff.

In addition, Division staff reviews applications from entities that request exemptions from provisions of the Investment Company Act or the Investment Advisers Act. By granting exemptive relief, the Commission can encourage innovation in financial products and services while assuring that appropriate investor protections remain in place. Exemptive relief also affords the Commission a means to adapt the application of the Acts to current markets and practices

Risk Monitoring

Pursuant to Section 965 of the Dodd-Frank Act, the Division established a new risk and examinations office. Division staff assigned to this office monitors trends in the asset management industry and carries out the Division's limited inspection and examination program. In addition, Division staff periodicallymeet with the senior management of large asset management firms and fund boards as part of the staff's ongoing outreach efforts.

Financial Stability Oversight Council

On December 18, 2014, the Financial Stability Oversight Council (FSOC) voted unanimously to release a notice seeking public comment regarding potential risks to U.S. financial stability from asset management products and activities. Division staff has reviewed the comments received on this notice and are working with the staffs of other FSOC members to analyze potential risks, if any, to U.S. financial stability from asset management products and activities.

Conclusion

Thank you again for inviting me to discuss the Division's activities and responsibilities. I am happy to answer your questions.

Questions for the Record for
David Grim, Director, Division of Investment Management
Securities and Exchange Commission
Submitted by Rep. Poliquin

QUESTION 1

Question: As currently written, proposed Rule 30e-3 would allow mutual funds to simply send investors a letter saying they would lose their paper statements unless they return a form. This policy would likely confuse investors, and some may forget to return forms. Additionally, these forms can be easily lost in the mail. What protections and/or systems does the SEC have in place to ensure that all shareholders actually receive this notice? What protections has the SEC made to ensure those who lose their paper statements can easily get them back? Please be mindful of the elderly who make own nearly half of mutual fund investment assets and are often without computers and the Internet. Please also explain how this would protect those with lower-incomes who may have similar predicaments, as well as those with Alzheimer's, dementia or similar diseases.

Response: The Investment Company Act and rules thereunder require funds to transmit shareholder reports to their investors at least semi-annually within 60 days after the close of the period for which such report is made.[1] Currently, reports can be transmitted either in paper or—with the shareholder's affirmative consent—electronically pursuant to the Commission's existing guidance on electronic delivery.[2] The proposed rule is structured so that compliance with the rule's conditions is an alternative, optional means of complying with the transmission requirements. For funds that elect to rely upon the proposed rule, failure to comply with its conditions (for example, failure to transmit through the mail not only the initial statement but also subsequent notices as shareholder reports become available, as discussed below) would violate the Investment Company Act and rule 30e-3 thereunder. The proposed rule applies only to annual and semiannual fund shareholder reports and would not affect, for example, account statements or prospectus delivery obligations.

In the proposing release, the Commission recognized that some investors prefer to receive paper shareholder reports and, under the proposed rule, those investors would be able make to an election at any time to continue to receive all of their reports in paper as they do today. Specifically, the rule as proposed incorporates a number of safeguards for investors who wish to continue to receive shareholder reports in paper. For example, under the proposal, a fund would be required to transmit a separate written initial statement at least 60 days before it relied on the proposed rule with respect to an investor. In addition to this initial statement, the fund would be required to send investors written

---

[1] *See* Section 30(e) of the Investment Company Act of 1940 [15 U.S.C. §80a-29(e)]; Rule 30e-1; Rule 30e-2.

[2] *See generally* Use of Electronic Media for Delivery Purposes, Investment Company Act Release No. 21399 (Oct. 6, 1995) [60 Fed. Reg. 52,458 (Oct. 13, 1995)].

notices each time a new shareholder report is made available. These periodic notices would not only alert investors to the electronic availability of a particular report, but also inform investors how they can receive paper shareholder reports on a going forward basis. In both the initial statement and the ongoing notices, the fund would be required to make available, in addition to the pre-addressed, postage-paid reply card, a toll-free telephone number that the shareholder could use to express his or his preference for paper reports. A shareholder can request paper copies of individual shareholder reports from the fund at any time, and the fund would be required, as a condition to reliance on the proposed rule, to send the shareholder reports, at no cost to the requestor and by U.S. first class mail or other reasonably prompt means.

According to a survey of households that own mutual funds published by the Investment Company Institute, in 2014, 86 percent of mutual fund-owning households with a head of household aged 65 or older had Internet access.[3]

Both the proposed separate written initial statement and the periodic written notices described above would be required to be written using plain English principles so that they will be easily understood by most investors.

QUESTION 2

Question: Two SEC-sponsored studies (by Siegel + Gale in 2012 and InfoTrends in 2013) indicate that the vast majority of Americans prefer to receive their statements in paper form. Most of the comments on this proposed rule reflect this concern. How will the SEC better incorporate these concerns in future drafts of Rule 30e-3?

Response: As noted above, in the proposing release, the Commission recognized that some investors prefer to receive paper reports. To avoid investor confusion and protect the ability of investors to choose their preferred means of communication, the rule as proposed incorporates a number of protections. For example, under the proposal, investors would receive a separate written initial statement and periodic written notices as each report is made available informing them how they can continue to receive paper shareholder reports. Under the proposed rule, investors would be able to request paper copies of the shareholder report on a going forward basis or on a per report basis and would be able to do so by, for example, calling a toll-free number. The staff is carefully reviewing comments received on the proposed rule, including comments concerning the ease with which investors who prefer paper reports can continue to receive their reports in paper.

---

[3] *See* Inv. Co. Inst., *2015 Investment Company Fact Book* 129 (55th ed. 2015), *available at* https://www.ici.org/pdf/2015_factbook.pdf.

QUESTION 3

Question: Please provide any cost/benefit study the SEC has done in relation to the paperless provision for Rule 30e-3. If it has not yet done so, does the SEC plan to quantify the potential cost this rule could have on consumers? Does the SEC have any evidence to suggest that under the current regulatory framework, shareholders who prefer to view these reports on-line have been impeded from doing so? If there is such evidence, please provide it.

Response: The Commission analyzed the expected benefits and costs of the proposed rule prior to issuing the proposal. The Commission's analysis is excerpted and attached as Exhibit A. Some expected costs and benefits of the rule for mutual fund investors were quantified in connection with the Commission's analysis. Other potential costs were discussed qualitatively. The staff is carefully reviewing comments received on the proposed rule, including comments on its analysis of benefits and costs. The staff is not aware of evidence suggesting that shareholders who prefer to view these reports online have been impeded from doing so.

QUESTION 4

Question: Some have suggested that the SEC could make it easier to allow investors to opt out of paper delivery of statements if they so choose. Why was this approach not included in the original draft of Rule 30e-3? Will this approach be given consideration in future iterations of the rule?

Response: The Commission's current guidance on electronic delivery generally allows several methods for investors to provide consent to electronic delivery of documents. For example, consent may be provided in writing, electronically, or telephonically as long as the principles contained in the Commission's electronic guidance are satisfied. The staff is carefully reviewing comments received on the proposed rule, and will give due consideration to any comments about the Commission's guidance concerning electronic delivery, as well as comments about other aspects of the rule proposal that we received.

EXHIBIT A

EXCERPT FROM INVESTMENT COMPANY REPORTING MODERNIZATION PROPOSING RELEASE

Economic Analysis: Option for Website Transmission of Shareholder Reports

a. *Introduction and Economic Baseline*

As discussed above, the Commission is proposing new rule 30e-3 under the Investment Company Act, which would permit, but not require, a fund to satisfy requirements under the Act and rules thereunder to transmit reports to shareholders if the fund meets certain requirements. These requirements include making the reports and certain other materials accessible on its website and periodically notifying investors of the materials' availability.[1] Funds that do not maintain websites or that otherwise wish to transmit shareholder reports in paper or pursuant the Commission's existing electronic delivery guidance would continue to be able to satisfy the transmission requirements by those transmission methods.

The current set of requirements under which funds transmit shareholder reports to investors is the baseline from which we will discuss the economic effects of proposed rule 30e-3. The baseline also includes the current practice of many funds to make some or all of these reports—or other materials listing portfolio investment information such as reports on Form N-Q—accessible on their own websites. The baseline also reflects that some funds transmit these materials electronically today, pursuant to Commission guidance that permits such a transmission method on a shareholder-by-shareholder "opt in" basis, provided that certain other conditions are met.[2] The parties that could be affected by new rule 30e-3 are funds that currently are or would be required to transmit shareholder reports under rule 30e-1 or 30e-2, and other current and future users of fund portfolio investment information, including investors and third-party information providers.

Today, most funds are required to disclose their portfolio holdings on a quarterly basis, with holdings as of the end of the second and fourth fiscal quarters disclosed in the fund's semiannual and annual reports, respectively, and holdings as of the end of the first and third fiscal quarters disclosed in reports on Form N-Q. Funds are generally required to transmit reports to shareholders on a semiannual basis, and these reports have historically been paper copies mailed to shareholders.[3] As of December 31, 2014, about 11,957 funds could rely on proposed rule 30e-3 if it were in effect.[4] As discussed in detail below, we estimate that these funds—and their shareholders—bear aggregate annual paperwork expenses of about $616 million in connection with the required

---

1 *See supra* Part II.D.

2 *See supra* note 289 and accompanying text.

3 *See supra* note 288 and accompanying text.

4 *See infra* note 799 and accompanying text.

preparation and transmission of shareholder reports (or about $51,539 for each portfolio).[5] Of those estimated expenses, we estimate that about $116 million are associated with the printing and mailing of shareholder reports.[6] Reports on Form N-Q are available on EDGAR.[7] Some funds choose to make some or all of these reports—or other materials listing portfolio holdings at particular times—accessible on their own websites, but funds do not do so uniformly.

As technology has developed, so has the need to modernize the manner in which shareholder reports and portfolio investment information are delivered to investors. As discussed above, recent investor testing and Internet usage trends have highlighted that investor preferences about electronic delivery of information have evolved, and that many investors would prefer enhanced availability of fund information on the Internet.[8] In addition, investor testing has suggested that fund investors are much more likely to seek out fund information on the fund's own website than they are to seek it out on EDGAR.[9] Moreover, searching for and retrieving individual reports on Form N-Q on EDGAR may, in many cases, be more difficult than navigating a website with which the investor is likely to be already familiar. We therefore believe that many investors may

---

[5] As discussed below, we previously estimated 994,960 aggregate annual internal burden hours associated with rules 30e-1 and 30e-2. *See infra* notes 853 and 855 (estimating 903,000 hours for rule 30e-1 and 91,960 hours for rule 30e-2). The Commission estimates the wage rate associated with these burden hours based on salary information for the securities industry compiled by the Securities Industry and Financial Markets Association. The estimated wage figure is based on published rates for attorneys and intermediate accountants, modified to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead, yielding an effective hourly rate of $268.50. This estimate is based upon the following calculation: ($380 per hour for Attorneys × 0.5) + ($157 per hour for Intermediate Accountants × 0.5) = $268.50. *See* Securities Industry and Financial Markets Association, Report on Management & Professional Earnings in the Securities Industry 2013. Based on the Commission's estimate of 994,960 burden hours per year and the estimated wage rate of about $268.50 per hour, the total annual paperwork expenses for funds associated with the internal hour burden of rules 30e-1 and 30e-2 are approximately $267,146,760. This estimate is based upon the following calculation: 994,960 hours × $268.50 per hour = $267,146,760. We have also estimated aggregate annual external cost burden of $349,105,750 associated with rules 30e-1 and 30e-2. *See infra* notes 854 and 856 (estimating $333,905,750 for rule 30e-1 and $15,200,000 for rule 30e-2). Therefore, we estimate that the total estimated aggregate annual paperwork expenses associated with rules 30e-1 and 30e-2 are $616,252,510. This estimate is based upon the following calculation: $267,146,760 expenses associated with internal burden hours + $349,105,750 external cost burden = $616,252,510. Using this estimate and our prior estimate of 11,957 funds, we estimate that annual paperwork expenses associated with rules 30e-1 and 30e-2 are about $51,539 on a per-portfolio basis. This estimate is based upon the following calculation: $616,252,510 aggregate annual paperwork expenses ÷ 11,957 funds = $51,539.

[6] We estimate that one-third of the external costs attributed to rules 30e-1 and 30e-2 relate to printing and mailing expenses. *See infra* notes 857–858. Therefore, we estimate aggregate annual printing and mailings costs associated with those rules of about $116,368,583. This estimate is based upon the following calculation: $349,105,750 aggregate external cost burden ÷ 3 = $116,368,583.33.

[7] *See supra* notes 637–642 and accompanying text.

[8] *See supra* note 292 and accompanying text.

[9] *See supra* note 292 and accompanying text.

not view the information that is available in reports on Form N-Q. Shareholders also pay, *pro rata*, the expenses associated with printing and mailing reports by default to shareholders, who may nonetheless prefer electronic transmission.

The economic effects of proposed rule 30e-3 are dependent on a number of factors, including the number of funds that would rely on the rule, the number of funds which currently rely on Commission guidance to transmit shareholder reports electronically, and the extent to which shareholders become more aware of the availability of portfolio investment information, view the information, and use the information to make investment decisions. Due to the optionality of the rule, we would expect that, in general, each fund would only rely on the rule if the benefits to that fund exceeded the costs. We have provided estimates of the costs associated with printing and mailing shareholder reports. However, information that would allow the Commission to quantify the other economic effects of the rule, such as how the availability of shareholder reports online will affect investors' use of the information, is not known to us.

Funds can transmit shareholder reports electronically today pursuant to Commission guidance. However, funds wishing to rely on this Commission guidance must satisfy certain conditions, including that shareholders agree to electronic transmission on a shareholder-by-shareholder "opt in" basis. We recognize that express shareholder consent can be difficult to obtain even for practices that many shareholders may prefer.[10] The number of funds that transmit shareholder reports electronically today is unclear to us, because funds are not required to report their reliance on the Commission's electronic delivery guidance or the number of investors that have given opt-in consent to receive electronic delivery. Commission staff is also not aware of information that describes the prevalence of electronic delivery of disclosure documents and other information. In addition, although survey evidence describes certain investor preferences regarding electronic delivery of shareholder report information,[11] we are not aware of information that would describe the effect of this rule on investor ability to choose between funds and allocate capital across all investments. For these reasons, much of the discussion below is qualitative in nature.

b. *Benefits*

The proposed rule, to the extent that it is relied upon by funds and alters the current transmission of reports, would increase the accessibility of portfolio investment information including information from the first and third fiscal quarters that might otherwise be only available on EDGAR. The proposed rule would thereby increase the awareness of fund shareholders of the availability of portfolio investment information, and therefore also increase the likelihood that fund investors review portfolio investment

---

[10] *See* Investment Company Act Release No. 22884 (Nov. 13, 1997) [62 FR 61933, 61935 (Nov. 20, 1997)] (concerning implied consent to delivery of disclosure documents to households).

[11] *See supra* note 292 and accompanying text.

information. The proposed rule would also increase the likelihood that fund shareholders view the portfolio investment information in their preferred format, and thereby increase their use of the information to make investment decisions.[12] Similar to the introduction of Form N-PORT and the amendments to Regulation S-X, greater investor use of shareholder reports could result in more informed investment decisions, particularly for individual investors, and an increase in competition among funds for investor capital. A greater understanding of the investment strategy of the fund, its portfolio composition, and its investment risks could also result in a more efficient allocation of capital across funds and other investments, and could thereby promote capital formation.

Funds and their shareholders would also benefit from a reduction in expenses related to the physical distribution of shareholder reports. Although the proposed rule would not have much of an effect, if any, on the expenses associated with the preparation of reports, we expect that the expenses associated with printing and mailing of shareholder reports would be substantially reduced if the rule is adopted. As discussed in detail below, of the estimated $116 million in annual paperwork expenses associated with the printing and mailing of shareholder reports,[13] we estimate that about $105 million would be eliminated if the proposed rule were adopted.[14] The actual reduction in paperwork expenses would depend, in part, upon reliance on the proposed rule by funds and the extent of shareholder consent to electronic transmission of reports, each of which is uncertain.

The expected benefits would not necessarily be distributed uniformly across funds and across a fund's shareholders. Some funds already transmit materials electronically to some or all of their shareholders, and these funds would experience fewer benefits from electing to rely on the proposed rule. Some funds, such as funds that do not currently maintain websites, may choose not to rely on the proposed rule.

c. *Costs*

Although we believe that permitting electronic delivery "by default" would improve overall alignment of transmission method with investor preferences,[15] there may be some

---

[12] *See supra* notes 291–296 and accompanying text (concerning investor Internet usage statistics and transmission method preferences).

[13] *See supra* notes 5–6 and accompanying text.

[14] We estimate that about 90% of the $116,368,583 in paperwork expenses associated with printing and mailing shareholder reports pursuant to rules 30e-1 and 30e-2 would be eliminated if rule 30e-3 were adopted. *See supra* note 6; *infra* notes 857–858. Therefore, we estimate that about $104,731,725 of annual paperwork expenses associated with rules 30e-1 and 30e-2 would be eliminated if rule 30e-3 were adopted. This estimate is based upon the following calculation: $116,368,583 in aggregate annual printing and mailing expenses × 0.90 proportion eliminated = $104,731,724.70 eliminated annual printing and mailing expenses.

[15] *See supra* note 292. We believe that the change from requiring shareholders to "opt-in" if they wish to receive electronic instead of print copies of shareholder reports, to—as under the proposed rule—"opt-out" if they wish to receive print copies instead of electronic copies would increase the ability of funds

investors who would prefer to receive print copies that do not notify their fund of that preference and may be others that would benefit from print copies even though they prefer electronic transmission. These investors, depending on their ability and preference to access shareholder reports and portfolio investment information electronically, could overlook electronic deliveries or otherwise experience a reduction in their ability to access portfolio investment information, and could result in a decrease in their ability to efficiently allocate capital across funds and other investments. We have endeavored, through the consent and notice provisions of the proposed rule, to mitigate the potential costs associated with this possibility by requiring a fund wishing to rely on the proposed rule to alert an investor before beginning to transmit reports electronically and to notify the investor around the time each report is made accessible on the website. Although, as discussed above, an increase in investor use of shareholder reports could increase competition among funds for investor capital, funds that do not rely on the rule could be placed at a competitive disadvantage depending on whether investors choose funds based on their preference for website transmission.

As discussed above, reliance on proposed rule 30e-3 would be optional, and funds that rely on the rule would incur costs to adhere to the rule. Relying funds would incur paperwork expenses associated with satisfying the conditions of the proposed rule, such as making the materials publicly accessible; preparing, reviewing, and transmitting a notice to shareholders; soliciting the consent of each shareholder by sending them an initial statement; and printing and mailing shareholder reports and other materials upon request. As discussed in detail below, we estimate that these paperwork expenses would be, in the aggregate, about $32 million each year.[16] Relying funds would also incur

---

to transmit shareholder reports electronically. Although the preferences of shareholders would not change dependent on the form of consent, behavioral economic theory and empirical evidence suggest the likelihood that shareholders receive electronic transmissions of fund reports would be greater under opt-out consent rather than opt-in consent. *See, e.g.*, Richard H. Thaler and Shlomo Bernatzi, *Save More Tomorrow™: Using Behavioral Economics to Increase Employee Saving*, Journal of Political Economy, Vol. 112:1, S164-S187 (2004); Richard H. Thaler and Cass R. Sunstein, *Libertarian Paternalism*, The American Economic Review, Vol. 93:2, 175- 179 (2003). Thaler and Sunstein argue that a "status quo" bias results in the continuance of existing arrangements even if better options are available. The authors illustrate their argument with higher rates of initial enrollments in employee savings plans when enrollment is automatic as compared to when employees must first complete an enrollment form.

[16] Below, we estimate that 10,761 funds would choose to rely on proposed rule 30e-3. *See infra* note 799 and accompanying text. Below, we estimate that funds that elect to rely on rule 30e-3 will, on average, incur 0.76 burden hours per fund per year to comply with the website accessibility conditions of rule 30e-3. *See infra* note 808 and accompanying text. Therefore, in the aggregate, we estimate that such funds would incur about 8,178 burden hours to comply with these requirements. This estimate is based upon the following calculation: 0.76 burden hours per fund × 10,761 funds expected to rely on rule 30e-3 = 8,178.36 hours. The Commission estimates the wage rate associated with these burden hours based on salary information for the securities industry compiled by the Securities Industry and Financial Markets Association. The estimated wage figure is based on published rates for senior programmers, modified to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead, yielding an effective hourly rate of $303. *See* Securities Industry and Financial Markets Association, Report on Management & Professional Earnings in the Securities Industry 2013. Based on the Commission's estimate of 8,178 burden hours per year and the estimated wage rate of about $303 per hour, the total annual paperwork expenses for

funds associated with the internal hour burden imposed by the website accessibility conditions of rule 30e-3 are approximately $2,477,934. This estimate is based upon the following calculation: 8,178 hours × $303 per hour = $2,477,934.

Below, we also estimate that funds that elect to rely on proposed rule 30e-3 would incur average annual external costs of $500 per fund in connection with the requirement to provide a complete shareholder report upon request of a shareholder. *See infra* note 816 and accompanying text. We estimate that aggregate external costs to funds in connection with this requirement would therefore be about $5,380,500. This estimate is based upon the following calculation: $500 per fund × 10,761 funds = $5,380,500.

Below, we also estimate that funds that elect to rely on proposed rule 30e-3 would incur about 0.38 annual burden hours in connection with the initial statement conditions of the rule. *See infra* note 829 and accompanying text. Therefore, in the aggregate, we estimate that such funds would incur about 4,089 burden hours to comply with these requirements. This estimate is based upon the following calculation: 0.38 burden hours per fund × 10,761 funds expected to rely on rule 30e-3 = 4,089.18 hours. The Commission estimates the wage rate associated with these burden hours based on salary information for the securities industry compiled by the Securities Industry and Financial Markets Association. The estimated wage figure is based on published rates for compliance attorneys, modified to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead, yielding an effective hourly rate of $334. *See* Securities Industry and Financial Markets Association, Report on Management & Professional Earnings in the Securities Industry 2013. Based on the Commission's estimate of 4,089 burden hours per year and the estimated wage rate of about $334 per hour, the total annual paperwork expenses for funds associated with the internal hour burden imposed by the initial statement conditions of rule 30e-3 are approximately $1,365,726. This estimate is based upon the following calculation: 4,089 hours × $334 per hour = $1,365,726. Below, we also estimate that these funds will incur annual cost burden of about $216 per fund to comply with the initial statement conditions. This estimate is based upon the following calculation: $49 per fund per year for services of outside counsel + $333 per year per fund to print and mail initial statements = $382 per fund per year. *See infra* notes 837 and 844. Such funds would therefore incur about $4,110,702 in aggregate annual cost burden to comply with the initial statement conditions. This estimate is based upon the following calculation: $382 per fund per year × 10,761 funds = $4,110,702 per year. Thus the total estimated annual paperwork expenses associated with the initial statement conditions are $5,476,428. This estimate is based upon the following calculation: $1,365,726 associated with internal burden + $4,110,702 external cost burden = $5,476,428.

Below, we also estimate that funds that elect to rely on proposed rule 30e-3 would incur about 1.5 annual burden hours in connection with the notice conditions of the rule. *See infra* note 832 and accompanying text. Therefore, in the aggregate, we estimate that such funds would incur about 16,142 burden hours to comply with these requirements. This estimate is based upon the following calculation: 1.5 burden hours per fund × 10,761 funds expected to rely on rule 30e-3 = 16,141.5 hours. Based on the Commission's estimate of 16,142 burden hours per year and the estimated wage rate of about $334 per hour, the total annual paperwork related expenses for funds associated with the internal hour burden imposed by the website accessibility conditions of rule 30e-3 are approximately $5,391,428. This estimate is based upon the following calculation: 16,142 hours × $334 per hour = $5,391,428. Below, we also estimate that these funds will incur annual cost burden of about $1,190 per fund to comply with the notice conditions. This estimate is based upon the following calculation: $190 per fund per year for services of outside counsel + $1,000 per fund per year to print and mail notices = $1,190 per fund per year. *See infra* notes 840 and 845 and accompanying text. Such funds would therefore incur about $12,805,590 in aggregate annual cost burden to comply with the notice conditions. This estimate is based upon the following calculation: $1,190 per fund per year × 10,761 funds = $12,805,590 per year. Thus the total estimated annual paperwork expenses associated with the notice conditions are $12,816,518. This estimate is based upon the following calculation: $5,391,428 associated with internal burden + $12,805,590 external cost burden = $18,197,018.

initial one-time costs associated with establishing systems and procedures for compliance. We estimate that these expenses would be, in the aggregate, about $16 million.[17]

Thus, we estimate that the total annual paperwork expenses associated with satisfying the conditions of proposed rule 30e-3 would be $31,531,880. This estimate is based upon the following calculation: $2,477,934 associated with website accessibility conditions + $5,380,500 associated with provision of print report upon request condition + $5,476,428 associated with initial statement condition + $18,197,018 associated with notice condition = $31,531,880.

[17] Below, we estimate that funds that elect to rely on rule 30e-3 will, on average, incur an additional 0.08 one-time burden hours per fund in the first year to comply with website accessibility conditions. *See infra* notes 807–808 and accompanying text. Therefore, in the aggregate, we estimate that such funds would incur about 861 one-time burden hours to comply with these requirements. This estimate is based upon the following calculation: 0.08 hours per fund × 10,761 funds = 860.88 hours. Based on the Commission's estimate of 861 one-time burden hours and the estimated wage rate of about $303 per hour for senior programmers, the total annual paperwork expenses for funds associated with the internal hour burden imposed by the website accessibility conditions of rule 30e-3 are approximately $260,883. This estimate is based upon the following calculation: 861 hours × $303 per hour = $260,883. Below, we also estimate that about 113 funds that wish to rely on proposed rule 30e-3 but that do not currently have a website will incur one-time cost burden of $2,000 per fund to comply with the website accessibility conditions. *See infra* notes 804 and 811 and accompanying text. Such funds would therefore incur about $226,000 in aggregate one-time cost burden to comply with the website accessibility conditions. $2,000 per fund × 113 funds = $226,000. Thus the total estimated one-time paperwork expenses associated with the website accessibility conditions are $486,883. This estimate is based upon the following calculation: $260,883 associated with internal burden + $226,000 external cost burden = $486,883.

Below, we also estimate that funds that elect to rely on rule 30e-3 will, on average, incur an additional 0.92 one-time burden hours per fund in the first year to comply with the initial statement conditions. *See infra* notes 828–829 and accompanying text. Therefore, in the aggregate, we estimate that such funds would incur about 9,900 one-time burden hours to comply with these requirements. This estimate is based upon the following calculation: 0.92 hours per fund × 10,761 funds = 9,900.12 hours. Based on the Commission's estimate of 9,900 one-time burden hours and the estimated wage rate of about $334 per hour, the total annual administrative expenses for funds associated with the internal hour burden imposed by the initial statement conditions of proposed rule 30e-3 are approximately $3,306,600. This estimate is based upon the following calculation: 9,900 hours × $334 per hour = $3,306,600. Below, we also estimate that these funds will incur one-time cost burden of $762 per fund to comply with the initial statement conditions. This estimate is based upon the following calculation: $95 per fund for the services of outside counsel + $667 per fund to print and mail initial statements = $762 per fund. *See* notes 836–843 and accompanying text. Such funds would therefore incur about $8,199,882 in aggregate one-time cost burden to comply with the initial statement conditions. This estimate is based upon the following calculation: $762 per fund × 10,761 funds = $8,199,882. Thus the total estimated one-time paperwork expenses associated with the initial statement conditions are $11,506,482. $3,306,600 associated with internal burden + $8,199,882 external cost burden = $11,506,482.

Below, we also estimate that funds that elect to rely on rule 30e-3 will, on average, incur an additional 0.8 one-time burden hours per fund in the first year to comply with the notice conditions. *See infra* notes 831–832 and accompanying text. Therefore, in the aggregate, we estimate that such funds would incur about 8,609 one-time burden hours to comply with these requirements. This estimate is based upon the following calculation: 0.8 hours per fund × 10,761 funds = 8,608.8 hours. Based on the Commission's estimate of 8,609 one-time burden hours and the estimated wage rate of about $334 per hour, the total annual paperwork expenses for funds associated with the internal hour burden imposed by the notice conditions of proposed rule 30e-3 are approximately $2,875,406. This estimate is based

EXHIBIT A

We have endeavored to mitigate the costs associated with compliance with the rule's conditions by, for example, requiring that the required schedule of portfolio investment information as of the end of the first and third fiscal quarters be presented consistent with the reporting requirements of Regulation S-X. Most funds would have established procedures in place to prepare and review such disclosures and would be familiar with the disclosure requirements. Because reliance on the proposed rule would be optional, a particular fund would not be expected to rely on the proposed rule if the costs of the rule to that fund would exceed its benefits. Funds that do not rely on the proposed rule would therefore not incur compliance costs.

---

upon the following calculation: 8,609 hours × $334 per hour = $2,875,406. Below, we also estimate that these funds will incur one-time cost burden of $95 per fund to comply with the notice conditions. *See infra* notes 839–840 and accompanying text. Such funds would therefore incur about $1,022,295 in aggregate one-time cost burden to comply with the initial statement conditions. This estimate is based upon the following calculation: $95 per fund × 10,761 funds = $1,022,295. Thus the total estimated one-time paperwork expenses associated with the notice conditions are $3,897,701. This estimate is based upon the following calculation: $2,875,406 associated with internal burden + $1,022,295 external cost burden = $3,897,701.

Thus, we estimate that the total one-time paperwork expenses associated with satisfying the conditions of proposed rule 30e-3 would be $15,891,066. This estimate is based upon the following calculation: $486,883 associated with website accessibility conditions + $11,506,482 associated with initial statement condition + $3,897,701 associated with notice condition = $15,891,066.

HFSC CM Subcommittee Hearing entitled
"Oversight of the SEC's Division of Investment Management"
October 23, 2015

Questions for the Record from Congressman Hultgren (R-IL)

Mr. David Grim

In your testimony before the House Financial Services Committee Capital Markets Subcommittee on October 23, 2015, you testified "One of the provisions in there [Sec. 913 of the Dodd-Frank Act] involves the issue of sales of proprietary products and that's one of the considerations that we are looking at very carefully." Based upon the January 2011 "Study on Investment Advisers and Broker-Dealers" by the SEC, the comments you received on the study, and the considerable time you have had to review this information, how do you think the Department of Labor (DOL) came to the decision that proprietary products are an inherent violation of a best interest standard?

Do you believe it is important for any best interest standard to be business model neutral? Since you also testified your office is coordinating with DOL, why would the Department propose limitations that essentially amount to a prohibition on proprietary products?

In general, what are your thoughts on the concept of limiting the types of investments that can be held in retirement accounts? Given your knowledge of the financial services marketplace, do you think limiting the assets that can be held in retirement accounts is in the best interest of people saving for retirement? How have you communicated this information to DOL?

Response: As you know, the SEC staff is, at the direction of Chair White, working on a recommendation for the Commission to require that broker-dealers and investment advisers be subject to a uniform fiduciary standard of conduct when providing personalized investment advice about securities to retail investors. This work builds on an extensive evaluation of the differences in the standards that apply under the federal securities laws, which has underscored the many complex issues that need to be addressed in proposing a uniform fiduciary standard, including how to define the standard, how to address current business practices such as the use of proprietary products, and the nature of the potential effects of changes to existing standards on investors, particularly retail investors.

The staff is continuing to develop views on specific issues like those presented in your questions above. As part of the analysis, we are giving serious consideration to, among other things, the recommendations of the SEC staff study under Section 913 of the Dodd-Frank Act from 2011, which provides that offering only proprietary products shall not, in and of itself, cause a broker-dealer to violate a uniform fiduciary standard adopted under Section 913. We are also taking into account the views of investors and other interested market participants, potential economic and market impacts, and the information we received in response to a 2013 Commission request for data and other information.

I appreciate the concerns about the interplay between the DOL's rule proposal and existing requirements under the federal securities laws, and the potential for different standards applying to the provision of investment advice to retail investors. Because the DOL has its own perspectives, jurisdiction, and statutes, the rules DOL adopted differ from certain requirements under the federal securities laws, including with respect to the treatment of proprietary products. As separate agencies, the Commission, in advancing a proposal, and the DOL can each proceed with the appropriate standards that apply to advice-giving with respect to particular investments, to the extent consistent with their individual statutes.

I also understand, however, the importance of consultation among the agencies, and appreciate the impact that differences between standards in any rulemaking by the Commission and DOL's new rule and related exemptions may have on regulated entities, investors, and the markets. It is important to achieve the right balance in addressing these issues, while making sure investors, particularly retail investors, are appropriately protected and have access to the type of investment advice and services they need and can afford.

DOL did not include listed options in its prohibited transaction exemption or the best interest contract exemption of its proposal. Did DOL request input from the SEC on this matter? What input did the Division of Investment Management provide? What input, if any, did DOL include in its proposal?

The Department's proposal mentions annuities 172 times but the Regulatory Impact Analysis does not examine the impact of the rule on annuities, advisers, insurers, or the retirement savers using them. You testified "a lot of what we've been talking about with them [Department of Labor] has been on impacts; you know, the impacts of choices that they are making on investors." Given your role as a regulator for insurance products, what impact analysis did you share with the Department regarding its treatment of annuities?

What areas of the proposed rule could cause regulatory confusion because they contradict or request action that conflicts with an existing SEC or FINRA rule? How did this situation occur if there was coordination between the SEC and DOL?

Response: As you know, at DOL's request, Commission staff provided technical assistance in connection with DOL's rule proposal. Specifically, Commission staff had conference calls and in-person meetings with staff from DOL, during which Commission staff shared their technical expertise regarding the regulatory framework applicable to investment advisers and broker-dealers, including disclosure requirements and our approach to the conflicts of interest that can be created by, among other things, principal trading, differential compensation, and receipt of commissions. As part of these discussions, Commission staff shared their experiences and knowledge with how services are provided in the areas of the market subject to SEC oversight.

SEC staff also provided technical expertise on specific topics during the rulemaking process, including discussions regarding swaps, listed and unlisted options, and annuities. It is my understanding that prior to the proposal, Commission staff economists also discussed with DOL staff economists cost-benefit related issues and relevant academic literature. As is the case in

any rule, changes were considered throughout the rulemaking process, including changes based on Commission staff's technical assistance, but ultimately DOL determined what changes to incorporate in the final rule.

Consultation among the DOL and the Commission has been, and will continue to be, important, even though our rules may not be identical because the DOL and the Commission are two separate agencies with separate statutory mandates. Because DOL just adopted their new rule at the beginning of April, it is too early to determine the rule's impact, including any areas of confusion or conflict that may require further clarification. Commission staff will closely monitor the implementation of the rule and if it appears that any requirements directly conflict with the federal securities laws or raise interpretive questions, we will consider whether any further action is warranted.