

MEMO# 23141

December 22, 2008

Remarks by Senior SEC Staff at ICI's 2008 Securities Law Developments Conference

[23141]

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TO: CLOSED-END INVESTMENT COMPANY MEMBERS No. 66-08
COMPLIANCE MEMBERS No. 69-08
FIXED-INCOME ADVISORY COMMITTEE No. 35-08
INST. MONEY MARKET FUNDS ADVISORY COMMITTEE No. 38-08
MONEY MARKET FUNDS ADVISORY COMMITTEE No. 43-08
SEC RULES MEMBERS No. 145-08
SMALL FUNDS MEMBERS No. 76-08
INVESTMENT COMPANY DIRECTORS No. 26-08 RE: REMARKS BY SENIOR SEC STAFF AT
ICI'S 2008 SECURITIES LAW DEVELOPMENTS CONFERENCE

The Director of the SEC's Division of Investment Management, Andrew "Buddy" Donohue, and the Director of the SEC's Office of Compliance Inspections and Examinations, Lori Richards, delivered keynote addresses at the Institute's 2008 Securities Law Developments Conference, on December 15th and 16th. [\[1\]](#) Their remarks are summarized below.

2008: Important Accomplishments, Meaningful Lessons, and Getting Back to Basics
(Andrew J. Donohue)

&Mr. Donohue began by discussing the recently adopted Summary Prospectus rule, expressing his certainty about the success of the Summary Prospectus and thanking all who participated in the public and private sector collaboration to make it a reality.

Mr. Donohue then expressed his hope that the same cooperative spirit would be brought to the review of the money market fund model and its regulatory regime – one of the more important initiatives he expects to be undertaken in 2009. He described the challenges

posed to money market funds by the events of the last year, the important but sometimes conflicting goals of money market funds, the focus of current money market fund regulations, and important considerations for future reforms. He also reiterated several of the year's accomplishments in the money market fund arena, both on the part of fund sponsors and the Division of Investment Management, in responding to events in the credit markets.

Next, Mr. Donohue briefly discussed the Division's role in the development of regulatory actions intended to enable the closed-end fund industry to address the freeze in the auction rate preferred securities market. He mentioned a no-action letter to enable the development of liquidity protected preferred stock as a substitute for auction rate preferred securities, collaboration with the Treasury Department on tax considerations, and a Commission order permitting a temporary change to asset coverage requirements to permit redemption of auction rate securities.

Mr. Donohue next described what he termed the "non-crisis-related accomplishments" of the Division. These included a number of adopted rules in addition to the Summary Prospectus, including rules relating to the Sudan Accountability and Divestment Act, interactive data, and indexed annuities; he also listed several rule proposals, including those related to Regulation S-P privacy rules, references to credit rating agencies in Commission rules, Form ADV, and ETFs, as well as soft dollar guidance. He noted that the Exemptive Applications staff surpassed its goal for the year, issuing 66 exemptive orders, and mentioned other accomplishments of the Chief Counsel's office and the Disclosure Review office.

Finally, Mr. Donohue acknowledged his personal disappointment that he was unable to achieve his goals with respect to Rule 12b-1 reform and investment adviser recordkeeping modernization. With respect to Rule 12b-1, he expressed his belief that the staff made great progress in its thinking on possible approaches, and his hope that the Commission can address the remaining concerns in the near term. As to recordkeeping reform, Mr. Donohue suggested that the Division could look to the Summary Prospectus and apply many of the same principles to require improved recordkeeping, at a lower cost, by relying on technology rather than paper.

Mr. Donohue concluded by noting what he described as "perhaps the most meaningful lesson of all: sometimes it is important to get back to basics." He wondered whether some fund strategies have become too complex. He suggested that we could consider the past year an anomaly, but that perhaps the norm has changed. He suggested that fund managers and regulators need to expect and be prepared for more frequent market disruptions than in the past, and that if the fund industry is to remain strong, it should get back to basics – by embracing a core fiduciary culture and addressing the needs of investors, rather than following fads. He reiterated the importance of a compliance-oriented culture, and expressed his faith that the industry will stay strong by maintaining its commitment to fundamental pro-investor ideals.

The Role that Surveillance Might Play in the Risk-Based Oversight of Mutual Funds (Lori A. Richards)

Ms. Richards focused her remarks on how SEC oversight of mutual funds might be improved, particularly through the greater use of technology and data analysis. By way of background, Ms. Richards explained that the SEC transitioned to a risk-based approach to examinations in 2003, following a rapid growth in the number of SEC-registered investment

advisers. She noted that, in recent years, the SEC staff began to request and make better use of data provided electronically – thus allowing the staff, for example, to analyze trade data for patterns that might indicate arrangements or risks that could pose harm to an adviser’s clients. Ms. Richards acknowledged that the SEC’s program relies heavily on on-site examinations, which she described as “indispensable,” but expressed the view that it could be “improved, supplemented and better focused” by having a “robust ongoing surveillance function at the SEC.”

Ms. Richards next commented that an effective risk-based oversight program requires routine access by SEC examination staff to “a set of reliable information about each firm surveilled to be able to gauge the relative compliance risk that each entity presents at a point in time and to monitor changes to these risk profiles over time.” She expressed the view that a mutual fund surveillance program would provide numerous benefits, including enhanced investor protection and greater efficiencies for both mutual funds and the SEC staff, and could build upon funds’ recent experiences with providing electronic data to the SEC.

In creating a “robust” surveillance program, Ms. Richards remarked that there would need to be significant discussion and analysis of the types of data and information needed, as well as the frequency with which it would be provided. For illustration purposes, Ms. Richard suggested that such data might include:

- General fund-level information, such as the net asset value per share, the shadow price for money market funds, total net assets and shares outstanding, the percentage of the portfolio that is fair valued, the percentage that is illiquid, a description of each share class, and the primary investment objective or style of the fund; and
- Specific information concerning each portfolio security held by the fund.

Ms. Richards also discussed the means by which such data could be made available to the SEC, including by having funds post the required data to a “shared space in their IT environment” which could be accessed by the SEC staff. She concluded by expressing the hope that the SEC staff and the fund industry will work together to further explore the ideas outlined in her remarks.

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endnotes

[1] Mr. Donohue’s remarks are available on the SEC’s website at <http://www.sec.gov/news/speech/2008/spch121508ajd.htm>, and Ms. Richards’ remarks are available at <http://www.sec.gov/news/speech/2008/spch121608lar.htm>.

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